Consultation Response
Financial Conduct Authority:
Proposals for a price cap on high-cost short-term credit

August 2014

Who we are

Toynbee Hall has worked on the frontline in the struggle against poverty for 130 years. Based in the East End of London we give some of the UK's most deprived communities a voice, providing access to free advice and support and working together to tackle social injustice.

Toynbee Hall helps over 13,000 people a year. Our years of experience in providing people with the skills to improve their financial health, means that we are in an ideal position to help others improve their financial health policies and practice. We have used this understanding to create the Financial Health Exchange.

The Financial Health Exchange is committed to creating a fairer, more financially healthy society and our aim is to improve financial health in the UK. We help policy-makers and practitioners stay up to date on the latest financial health thinking and ensure that financial health good practice is followed in all of their work with clients and service users.

We are at the forefront of shaping the future of financial health in the UK. Our publications, research, good practice examples and expert opinion pieces are accessible to all those who want to improve the financial health of others.

Many of our members work directly with people that are affected by high-cost short-term credit. The added pressure this sector has placed on people already in difficult financial situations has been a common theme in our interaction with members in recent years. We regularly respond to consultations to reflect our members' views and encourage policymaking which recognises the importance of financial inclusion as a tool for tackling poverty.

Introduction

We welcome the opportunity to comment on the Financial Conduct Authority's (FCA's) proposals for placing a price cap on high-cost short-term credit (HCSTC). We have been supportive of the FCA's tougher stance towards this market since it took over regulation of consumer credit in April 2014. HCSTC continues to cause detriment to consumers and strong regulation is vital to fixing the problems with the market.

We view the FCA's intentions regarding the price cap as a significant step to ensuring consumers do not pay more for short-term credit than is appropriate, affordable or ethical. We do, however, believe that the price cap will place limits on the market that will inevitably decrease supply, leaving a subset of vulnerable consumers further excluded from access to regulated credit. Thus we urge the FCA to monitor the unintended consequences which may arise as a result of the cap and remain flexible to amend it or propose other solutions if necessary.

We hope the FCA's intervention will form part of a wider effort to protect vulnerable and financially excluded consumers. The price cap should not be seen as a panacea and the regulator's tough stance on HCSTC will only achieve its desired goals if it is combined with action across the financial services industry. To this end we recommend that the FCA:

1) Continues to engage with mainstream financial service providers on financially excluded consumers' access to key services like reasonably-priced credit;
2) Provides a supportive regulatory framework for alternative affordable credit providers like credit unions and community development finance institutions (CDFIs);
3) Recognises the power held by credit reference agencies (CRAs) to lock consumers out of access to credit;
4) Encourages a broader culture change in the financial services industry where creditors are given a duty of care to borrowers – the FCA's insistence that HCSTC firms refer customers who are struggling to make repayments to free debt advice is an example of this.

In this consultation response we will explore each of these points in further detail and answer the specific questions posed by the regulator.

Responses to individual questions

Q1: Do you have any comments on our general approach to developing our proposals for the price cap?

The general approach to the development of the price cap proposals has been well researched. We welcome the FCA's collaboration with the Competition and Markets Authority (CMA) to gather the best possible knowledge of how the HCSTC market operates in the UK. When the price cap takes effect on 2nd January 2015, we urge the regulator to recognise the need for a flexible approach where positive and negative consequences are reviewed and the cap can be amended if necessary.

Q2: Do you have any comments on the proposed price cap structure? Q3: Do you have any comments on the price cap levels?

We have decided to answer consultation questions 2 and 3 together as we believe the structure and levels of the cap will work in conjunction to affect the HCSTC market.

We broadly support the proposed price cap structure and price cap levels. We are satisfied that the FCA has gained an in-depth understanding of how the HCSTC market is operating and the consumer benefit and harm that could result from the application of the proposed cap.

All research indicates that excessive charges on HCSTC loans are causing significant consumer detriment, particularly to borrowers who only just get loans. We are especially concerned about vulnerable customers' debt spiralling out of control as a result of these loans; the FCA's research reveals that "when they apply for HCSTC loans, many customers are in a difficult, and deteriorating, financial situation."[1] Therefore the initial case for a price cap is strong.

Regarding the specific structure and levels of the price cap, we support the FCA's decision to impose caps on daily interest, default fees and the total cost cap. We agree that there is a requirement for these three elements of the cap to make it effective.

The 0.8% cap on daily interest will save money for those consumers who are still able to access HCSTC and typically pay back their loans on time. It a positive step towards preventing people from paying excessively for short-term credit.

Default fees have long been a concern for us. An investigation conducted by consumer group Which? in January this year found these charges were often excessive – with many lenders charging over £20 – sometimes tipping consumers into a spiral of debt.[2] We therefore back the FCA's decision to cap default fees at £15.

Finally the total cost cap set at 100% of the principal amount borrowed, so a customer will never pay back more in interest and charges than the amount borrowed, will further prevent debt spirals and we agree that it sends a clear message to consumers about when they are being charged an unlawful amount for HCSTC.

Although we generally support the structure and levels of the price cap we also believe, as the FCA itself has noted, that the price cap applied at these levels will exclude people from the market and perhaps from regulated credit altogether. We feel this has the potential to cause significant detriment to a subset of consumers. Below we discuss how the FCA could approach dealing with this problem.

A further concern we have with the structure of the cap is the fact that the FCA has only guaranteed to review it after two years. We recommend that the regulator monitors the impact of the price cap after a shorter time period to ascertain whether any negative unintended consequences are occurring.

Q4: Do you agree with our proposals on repeat borrowing?

[1] http://www.fca.org.uk/static/documents/consultation-papers/cp14-10.pdf

[2] http://press.which.co.uk/whichpressreleases/which-calls-on-payday-lenders-to-cut-high-fees/

We generally agree with the FCA's proposals on repeat borrowing. We support the regulator's decision not to apply rules related to how many times a borrower can take out a loan in a given time period because we are concerned this would further exclude people from access to credit. We judge that customers who are able to access credit will receive sufficient protection if the price cap is implemented in the same way as the first loan; they will pay less in interest and the total cost cap will limit cases where HCSTC debt spirals out of control.

However we urge the FCA to remain vigilant with the sector to ensure firms are carrying out robust affordability tests and not attempting to sidestep rules through repeat borrowing. Active supervision of firms to make sure they are identifying vulnerability in repeat borrowers is necessary. The move towards real-time data sharing, discussed in question 9, will enable better affordability tests to be carried out and limit detriment to repeat borrowers.

Q5: Do you have any comments on the scope of the price cap?

We agree with the scope of the price cap proposed by the FCA. At this stage we do not feel it is practicable to implement a price cap across the consumer credit market. However we strongly support the research that is presently being conducted by the FCA on the credit card market and the collaboration with the CMA on current account overdraft charges.

More broadly, we encourage the FCA to continue to engage with the mainstream financial sector and monitor their interaction with the most vulnerable groups. In particular the FCA should monitor vulnerable consumers whose overdraft or credit card debt may force them to use high cost forms of credit. We expect the regulator to act if it finds this to be a common path which is harming consumers.

Q6: Do you have any comments on our proposed Handbook rules?

We support the proposed handbook rules.

Q7: Do you agree with our proposals on unenforceability?

We agree that the FCA should make any loans that are unlawful under the price cap unenforceable. This gives a strong incentive for firms to comply with the cap. We hope the regulator invests the resources to actively supervise the market and identify when unlawful loans are being granted.

Q8: Do you agree that we should prevent UK-based debt administrators from enforcing HCSTC agreements on behalf of ECD lenders which include charges in excess of the price cap?

We agree that the FCA should prevent UK-based debt administrators from enforcing HCSTC agreements on behalf of ECD lenders which include charges in excess of the price cap. In order for this measure to have the desired effects, the FCA will have to improve consumer knowledge of when a loan is in breach of the cap. Due to the fast-moving nature of the market the regulator itself will also have to be actively aware of new online HCSTC firms entering the market and lending to UK consumers.

Q9: Do you have any comments on the proposed approach to data sharing?

We welcome the FCA's ambition for 90% of HCSTC lenders to be participating in real-time data sharing by November and to share data with more than one CRA. We feel the move towards real-time data sharing is essential for HCSTC firms to properly assess potential borrowers' creditworthiness, given the fast-moving nature of the market. If sufficient progress cannot be identified by November, we expect action to be taken to make it mandatory for firms to share data.

Furthermore we encourage the use of real-time data sharing across the entire consumer credit sector as a key facet of affordability testing. We anticipate that this will improve the identification of vulnerable consumers who need to be referred to debt and money advice rather than granted another loan. Additionally real-time data sharing could help alternative affordable lenders such as credit unions and CDFIs make more confident lending decisions thereby aiding their growth and development.

Although we understand the FCA's decision not to establish a 'regulatory' real-time database that it has responsibility for overseeing at this time, we think it should be prepared to take this action in the future if firms are failing to comply with data sharing requirements.

Q10: Do you agree with the costs and benefits identified?

We agree with the FCA that consumers who can still access HCSTC will benefit from the cap because of lower prices. However we feel that the cap will inevitably distort the market and create the potential for consumer detriment in other areas.

The consultation document estimates that 11% (about 160,000 people a year) of those who are eligible to receive HCSTC after the 2nd January 2015 will no longer be able to access it, and a further 14% will face "reduced access"[3]. These consumers' demand for credit will not simply go away and we urge the FCA to be proactive in using all powers within its regulatory remit to find solutions for them.

For some consumers who will be excluded by the price cap, credit was probably not the correct solution for their finances in the first place. These consumers will potentially benefit from being denied access to HCSTC. We hope that the cap will encourage these consumers to seek better solutions for their finances such as accessing free debt and money advice or affordable credit. We argue the FCA has a role to play ensuring consumers know about and have access to these solutions.

Other consumers have a pressing demand for credit and will likely suffer more immediate detriment from being denied HCSTC. Although the FCA's survey results found few HCSTC customers were likely to consider illegal money lenders[4], we urge the regulator to liaise closely with the illegal money lending team to monitor any changes in this situation as a result of the price cap.

Q11: Do you agree with our assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?

We have interpreted this question as applying generally to vulnerable consumers and people who are excluded from mainstream financial services as this is a key client group for our members.

[3] http://www.fca.org.uk/static/documents/consultation-papers/cp14-10.pdf

[4] Ibid.

The FCA could help to protect vulnerable consumers further by driving a culture change across the consumer credit industry, where credit providers are given a duty of care to borrowers.

Affordable and ethical credit providers, such as credit unions, have a natural duty of care to their members. They should be given the regulatory space to innovate, develop sustainable business models and continue to offer financial services to a wider range of consumers, including the financially excluded. The FCA predicts there will be a major reduction in HCSTC lenders based on the high street as a result of the cap, with perhaps only one firm still operating with this business model. We hope the regulator can help to support credit unions fill this gap important gap in provision, particularly as many consumers lack the digital skills to access credit online.

The FCA should also continue to examine how mainstream financial institutions like banks and building societies provide access to services – including credit – for the financially excluded. Across the consumer credit market, we believe the FCA can impact consumer outcomes through active supervision and co-operating with firms to establish best practice.

We further propose that the FCA to investigates the power of credit reference agencies (CRAs) to lock people out of credit and possible remedies to this.

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