Financial Conduct Authority Call for Input: High-Cost Credit

TOYNBEE HALL

About us

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.

We are also leaders in the UK's financial inclusion, capability and debt advice sectors. 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 are the lead contract agency for Capitalise, the Money Advice Service funded face to face debt advice provision for London, and we sit on the Money Advice Service's Debt Advice Steering Group and Financial Capability Strategy Board, as well as a range of other national level government, regulatory and industry groups working on improving financial health and inclusion.

Through our Financial Health Exchange, we manage a cross-sectoral network of over 500 individuals and organisations with the aim of achieving a financially fair and healthy society. The Financial Health Exchange provides opportunities to share knowledge about what works, develop good practice, and shape financial health policy in the UK.

For more information about us please go to:

www.toynbeehall.org.uk
www.financialhealthexchange.org.uk

Our response to the Call for Input: Key Points

We welcome the FCA's call for input to inform further work on high-cost credit, including a review of the high-cost short-term credit price cap.

In our community debt advice and financial capability work across London and in our national financial health policy and practice programmes, we see how credit plays an increasingly important role in people's financial lives, with higher cost forms of credit becoming more prevalent for a larger proportion of consumers.

Our research has explored the complexities of household borrowing in much more detail and has found, for example, that access to high cost credit at the swipe of a smartphone is putting younger generations at risk of growing up in greater financial exclusion[1]. We've also seen how fees and charges associated with overdrafts put vulnerable consumers and those on low incomes at a high risk of becoming excluded from banking all together. Additionally, high bank charges and fees related to overdrafts and credit cards can increase the chances of someone missing a debt repayment[2].

Overall, it is our aim to see effective policies and regulation of financial services which achieve the following:

- borrowers are protected from irresponsible lending practices
- information asymmetries that make it difficult for consumers to get the best deal are eliminated
- firms act in the interest of their customers and intervene early when they identify that a customer may be in financial difficulty
- any excessive levels of profit earned from unfair pricing structures are eliminated

Since taking over regulation of consumer credit in 2014, the FCA has made significant progress in protecting consumers from harm and took swift action to eliminate the most egregious practices in the HCSTC sector. But there is evidence that consumer detriment persists in other areas. We therefore see the FCA's review of high-cost credit as an opportunity to:

1) develop a consistent approach to consumer protection across all credit sectors
2) create an obligation on firms to share data in real time, which would provide lenders with a more detailed picture of the financial pressures people might be facing and help them make better decisions about whether a consumer is eligible for a loan under the FCA's responsible lending rules, and
3) consider how a duty of care could further protect consumers from detriment

We believe this approach will enhance and maximise the effectiveness of regulation and offer robust protection for consumers.

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?

It is our perspective that it is both feasible and desirable for there to be a consistent approach to high-cost products. The consumer base for both HCSTC and other high-cost credit products share many characteristics, such as being on a low income or having income primarily through benefits, residing in social housing, and having a higher than average incidence of vulnerability.

However, wider public policy changes have meant that this customer base is growing, comprising more and more younger consumers, those in the private-rented sector, and those with higher incomes. An increasing number of consumers are paying a higher cost for their credit, and this will make them more vulnerable if the right protections are not in place.

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[1] http://financialhealthexchange.org.uk/wp-content/uploads/2016/11/millennials.pdf
[2] http://financialhealthexchange.org.uk/wp-content/uploads/2017/01/Poverty-Premium-Research-Report.pdf

Furthermore, the current picture of consumer credit use suggests that increasing numbers of households are managing multiple types of credit from providers in different sectors, and this will include a mix of higher cost and mainstream credit. It appears that increasing numbers of consumers do not distinguish between credit markets in the same way policy makers and consumer advocates do, and because of this we think it is necessary for the FCA to take a consistent approach to conduct risks, regardless of the sector in which they occur. This should minimise the likelihood of "detriment" being displaced from one credit sector to another, as all lenders will be expected to meet the same standards.

An overview of borrowing trends from Capitalise

We reviewed our data from the Capitalise partnership from April 2015 – March 2016 to identify borrowing trends and to understand more about high cost credit usage among our service users. Across the Capitalise partnership, credit cards (including store cards) made up the largest proportion of consumer credit debt among clients (27.5% of all clients had credit card debt, and these debts made up 12% of all debts in 15/16). Among the credit card debt is a fairly large amount of borrowing on high interest (sub-prime) credit cards, with most debt clients having multiple credit cards with high balances. It is not possible within our data collection system to distinguish between credit card lenders, however analysis of client case notes uncovered that subprime cards are just as common as mainstream credit cards. Overall, credit card debt was the 3rd highest debt type after rent arrears and council tax. The 4th highest type of debt among clients was overdrafts, representing 12% of advice clients and 5% of all debts.

8% of Capitalise clients had debts with other financial institutions, a category which includes a range of high cost credit products such as payday loans, guarantor loans, and door step loans. This category represented approximately 3.7% of all debts in 15/16.

3.7% of Capitalise clients had loans from friends or family, with an additional 1.8% of clients having loans from other individuals. It is not known whether these "friends or family" or "other individuals" represent illegal money lenders as this is not something that is normally disclosed by clients, but it is worth noting that clients often prioritise repaying these debts over other essential expenditure.

Therefore, the review should include not only "traditional" high-cost products (payday loans, rent to own, home credit, logbook loans, etc.) but also sub-prime credit cards and overdrafts. Further analysis of our debt advice cases, described in more detail below, suggests that other forms of high-cost credit such as instalment loans and guarantor loans should also be reviewed.

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

There are some faint signals throughout the Capitalise partnership that problems are beginning to emerge in certain sectors of the market. In particular, our Capitalise advisors have raised concern over guarantor loans, which have been increasing over the last few years, although they still remain a very small proportion of debt cases. They have noted that prior to the payday loan cap, guarantor loans were very rare, but this is starting to change. Since these loans have started appearing in debt cases, concerns have been raised over a number of issues.

For example, there is concern that some firms may not be applying adequate affordability checks on both borrowers and guarantors, leaving both parties with loans they cannot afford to pay back. Of the guarantor loans our service has seen, both the borrower and the guarantor had been on very low incomes and unable to afford the agreement. Additionally, we have found that our clients who are acting as guarantors are usually unaware of what they've signed up for and have little awareness of what the responsibilities of a guarantor are. It is common for lenders to fulfil their obligations to provide pre-contractual information to guarantors over the phone (for the purposes of meeting obligations outlined in Principle 7 of PRIN), where they also confirm the guarantor's understanding of rights and responsibilities. Furthermore, clients have described being placed under great pressure by a family member with little understanding of the implications, Advisors have expressed that there is a highly emotional aspect to guarantor lending as it has the potential to lead to relationship breakdown and could become a means of financial abuse. Because of the longer term of the loan and large amounts that can be borrowed, we feel there is significant risk of detriment if affordability checks are not done appropriately and effectively. We therefore recommend that the FCA lead a more in depth review of this sector of the market.

We believe that it is necessary for the FCA to carry out a review into this sector of the market in order to better understand whether the processes and procedures of guarantor lenders are appropriate and effective for meeting their obligations to customers as outlined in PRIN (especially Principle 6 and Principle 7).

Detriment from high-cost credit products also arises from the fact that higher cost credit tends to be paid first over other priority or essential bills such as rent. While our Capitalise advisors noted that some financial services firms, such as banks and credit card companies are getting much better at dealing with customers in financial difficulty, other credit markets tend to be more aggressive in their collection practices, such as the rent-to-buy and guarantor sector. More aggressive collection practices coupled with the higher cost of these products pushes people to the point that they prioritise these debts over others.

Finally, members from our Financial Health Exchange network and Capitalise partners explained that consumers who use rent-to-buy products are often subjected to misleading and high pressure sales tactics that result in purchasing the most expensive item or buying multiple items, which substantially increases the cost of credit and overall debt burden. In their review of the high cost credit market, the FCA should also ensure that there is a sufficient level of scrutiny of point of sale and marketing practices and whether rules should be amended to eliminate misleading advertising or high pressure sales practices which treat consumers unfairly.

Case study 1

"One client I saw had come to the service to get advice after receiving a letter from the court about an unsecured loan from a Guarantor loan company. The client had agreed to act as guarantor on a

loan for her partner, for the amount of £4250. Both the client and the partner had irregular incomes due to zero hour contract jobs, and the client was making an income of about £700 a month. The client also had 2 young children and was a "sofa surfer", meaning that she did not have permanent accommodation and was on the local authority's housing list. While the liaisons from the Guarantor loan company suggested that they had taken appropriate steps to ensure the client understood the terms and conditions of the agreement, it is questionable whether the client really did understand her responsibilities and whether the loan company adequately met their requirements to assess affordability in this case, as the loan agreement was completely unaffordable".

-Toynbee Hall Capitalise advisor

Case Study 2

"One client had them [rent-to-buy] knocking on her door six times a day up to 8pm. Her neighbour got rid of them and asked them to stop harassing her. Another client pays Bright House £70 per week out of her £73.10 benefit payment. We have found that clients go to order the cheapest possible item but are persuaded to buy the most expensive possible item"

- Financial Health Exchange member, community-based charity in the NW providing debt advice and other anti-poverty services

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?

Detriment arises for both reasons. Firstly, the regulatory definition of high-cost short-term credit has excluded many other products from certain rules designed to enhance consumer protections. For example, unarranged overdrafts do not fall under the HCSTC cap but are comparable to payday loans as they are designed to be a short term credit option. New rules and guidance for price comparison websites comparing HCSTC products do not cover high-cost products that are excluded from the HCSTC definition even though consumers would benefit from these rules.

Our analysis from the Capitalise data, which is supported by research from other organisations such as StepChange[3], suggests that there are still issues with lending practices. StepChange's research found that over a third of their clients with HCSTC debts have three or more such debts and three quarters of clients in their survey said that they got a HCSTC loan when they already had outstanding HCSTC. Among our Capitalise clients, those who have a debt related to high-cost credit have an average of 4 non-priority debts, and 40% of clients with credit card debt also had a high-cost credit product. We recommend that the FCA review whether this represents a failure to comply with the rules or whether the rules do not go far enough to adequately protect consumers from irresponsible lending.

Our perspective is that there is a compelling case for regulation to enable more effective data sharing. Real time data sharing would provide lenders with a more detailed picture of the financial pressures people might be facing.

For certain credit products, such as credit cards and personal loans, we see detriment mainly arising from multiple/repeat borrowing, where a client has multiple credit products with various providers, creating a significant repayment burden that is difficult to maintain on a

[3] https://www.stepchange.org/Portals/0/documents/Reports/Payday-loans-next-generation.pdf

low income, or in the incidence of a drop in income, which is common amongst the clients we see at our Capitalise debt service. Additionally, current credit repayments (and other essential expenditure) can become difficult to maintain when a debt collection order arises (which are often for older or unknown debts), both from utility-based debt, mobile phone debts, and older credit agreements.

A system would be considered real time only if every inquiry and every lending decision is updated instantaneously across 100% of the market. That would allow for lenders to know immediately if a consumer is eligible for a loan under the FCA's responsible lending rules.

Obliging lenders to share their data in real time should be an essential part of the FCA's strategy to ensure consumer protection in all lending markets. Such a system is crucial for better affordability checking, and would ensure that lenders are fully aware of borrowers' existing commitments and would prevent people from taking on more credit than they are able to manage. Furthermore, the information from the database should help the FCA assess affordability of borrowers, and also to trigger signposting to advice services.

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?

We believe that protections equivalent to those applied to HCSTC should be applied across all forms of consumer borrowing where there is evidence of detriment. There should be greater expectation on firms to prevent detriment, rather than deal with it when it has already occurred.

We believe that the high cost credit review provides an opportunity for the FCA to consider how a Duty of Care could protect consumers from detriment in the credit market. According to the Financial Services Consumer Panel, there are numerous cases where the FCA Principle of Treating Customers Fairly (TCF) is failing consumers, but where firms have not been breaking FCA rules. The Financial Services Consumer Panel have provided a number of examples to illustrate the problem, for example[4]:

Credit card companies exploit 'minimum payers', who are paying interest rates typically 15-20% above base rate. They offer increased credit limits without conducting affordability checks. And, as the result of just one missed payment, or breaching the credit card limit, firms can immediately withdraw an interest-free credit card offer, which is likely to result in high interest charges. Under a duty of care, firms would only offer appropriate products with affordable credit limits to consumers, and firms would only have transparent and proportionate fees and charges.

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

Please see above.

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

[4] https://www.fs-cp.org.uk/sites/default/files/duty_of_care_briefing_-_jan_2017.pdf

Overdraft usage and behaviour is a far more complex picture than the question suggests. The reality is that consumers are using a combination of credit cards, bank loans, overdrafts, and payday loans to meet their needs and make payments. For example, analysis of Capitalise data found that 23% of clients with overdraft debt also had a payday loan. However, there are signs that for a minority of consumers, high-cost credit products act as an alternative to overdrafts or other mainstream credit products. For example, there were a very small number of cases whereby clients were indebted to multiple payday loan providers, with no other debts. In these cases, the clients were in casual employment, being paid in cash, and were migrant workers. Therefore, saying that overdrafts are a substitute or alternative to other high-cost credit products would not paint an accurate picture.

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

Overdrafts are an enormously complex product and we have found that it is difficult to generalise about the behaviour and usage of overdrafts among consumers.

In our research for the Lloyds Consumer Digital Index[5], we interviewed 31 unbanked consumers and surveyed a further 104, to understand more about their financial and digital capability skills. In this research we found that the main motivation for becoming banked was simply that the consumer wanted one and saw it as a potential benefit, something that could help them monitor their finances and buy things online. But the majority of people we spoke to also expressed that they didn’t want credit cards or an overdraft facility, as they felt it was too easy to get into out of control debt. In fact, we found that three quarters of those who had previously been banked had left the banking system by allowing the account to be abandoned due to debts on the account, leaving them to feel that bank accounts no longer worked for them. Overdrafts and the associated charges put vulnerable consumers and those on low incomes at a high risk of becoming excluded from banking all together, which makes overdrafts a priority for the FCA’s review.

For some consumers, overdrafts serve as a source of short-term credit that can help smooth income or provide credit in emergencies. For the majority of our debt advice clients, the overdraft is a static feature of their financial lives. Our Capitalise partners expressed that they would be reluctant to deny an overdraft facility to the clients they see as they could be driven to far more expensive or unregulated forms of credit without it. However, there is also concern that the fees and charges clients experience, for both arranged and unarranged overdrafts, are disproportionate compared to the amount borrowed. Some clients face charges of £35 for going £5 into an unarranged overdraft, which swallows up the small amounts of income they have, leaving them unable to pay bills or meet other essential payments. Heavy reliance on overdrafts plus regular and expensive charges means that it becomes almost impossible to rebalance the account.

It is our perspective that the key issue with overdrafts is that, unlike payday loans, the customer is unable to stop charges without closing or switching the account. Reforms to the payday loan market stopped the cost of credit, including fees and charges from totalling more than twice what was borrowed. Once the cap is reached, there is a stop on fees and charges, which helps to prevent escalation of the debt. This is not the case for those who are frequent

[5] http://www.lloydsbank.com/banking-with-us/whats-happening/consumer-digital-index.asp

users of overdrafts, especially those on debt management plans as they often cannot escape the reliance on overdrafts. When clients are in financial difficulty, advisors will usually advise the client to switch to a basic bank account so that they can stop charges on the account. However, there is often a reluctance from clients to follow this advice as they feel dependent on their overdraft facility to get them through the month. The stress of dealing with multiple debts and arrears means that switching or opening a new bank account is not a high priority for clients, even if they know it will benefit them to do so. For this reason, regulatory interventions which focus too heavily on consumer switching will never improve outcomes for those who are the most vulnerable.

Case study 3

"During our research we spoke to one woman in her sixties who used to have a bank account with a well-known high street bank. She struggled to access finance from other sources to pay her bills, found that her direct debits were being withdrawn and was unaware of how to stop them. She eventually had to disown the account, rendering her unbanked, owing £4,000 on her overdraft generated from missed direct debits".

-Carl Packman, Research and Good Practice Manager, Toynbee Hall

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

We are concerned that there is too much focus among the regulators (including the CMA) on advocating account switching to solve these problems, without realising some of the barriers consumers have in doing it. To date, switching remains low and has thus not led to innovation around the needs of low-income consumers, particularly those who regularly go overdrawn. While Open Banking has promised to make it easier for customers to compare bank accounts and overdraft charges, it is not likely that this will be enough to bring the necessary protections for vulnerable consumers, especially those on the lowest incomes and those who are on debt management plans. For customers who are just struggling to make ends meet, it's crucial that their bank account actively helps their money go further rather than reducing it through fees and charges, and engage in regular reviews with customers to ascertain whether their financial situation has changed since the credit facility was provided and whether the product is still suitable for them. This should include signposting customers to debt advice providers as regular use of overdrafts is an indicator that they may be in financial difficulty.

Currently there is a complex array of charging structures in the overdraft market, with some banks imposing daily fees, some imposing monthly charges, and some charging interest on the amount owed. In many cases banks use a combination of these methods, making comparisons between banks difficult.

In order to really understand how the current overdraft market is working for consumers, we argue that more thorough analysis is needed, to understand how the costs associated with overdrafts compare to other credit markets. The sector would benefit from a more robust understanding of which consumers are being charged arranged overdrafts fees as opposed to unarranged overdraft fees, how the overall costs for arranged/unarranged overdrafts compare to other credit markets, and whether the overdraft market is out performing other markets. The FCA should prioritise its review of the high-cost credit market to determine whether or not these rates are disproportionate to the cost of providing the facility, and also look to determine what would be a fair cost for the service, as it has done for the high-cost short-term credit market.

Finally, the complex and variable role of overdrafts in consumers' financial lives suggests that, the current model for overdraft borrowing may no longer be fit for purpose for some consumers, primarily those who have a need to smooth expenditure over the month, or move from short-term to long-term borrowing. The introduction of new payment methods such as Request to Pay, announced as part of the PSR's new payments strategy for the 21st century, is a welcomed approach that will likely help alleviate some of the problems consumers face, but we urge the FCA to explore as part of its high cost credit review whether further innovation can provide more appropriate and cheaper alternatives to overdrafts.

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**
- **whether this decline will continue, plateau, or lending will increase**
- **the impact of the price cap on the viability of HCSTC and how this might differ for online and high-street, and**
- **the impact on loan duration and product development more generally of the structure and level of the price cap**

Based on the information gathered through our Capitalise service, it is not easily determinable what the reason is for a reduction in applications for HCSTC, and the reduction in acceptance rates by firms. In 2015-16, 8.4% of Capitalise clients had loans from "other financial organisations", which includes payday loans, but also includes instalment loans, guarantor loans, and other higher cost unsecured loans. Therefore, it is reasonable to assume that the number of clients with traditional payday loan debts is actually lower than this. These loans accounted for 3.7% of all Capitalise debts.

As of November 2016, 7.5% of Capitalise clients had a loan from other financial organisations including payday loans, making up 3.5% of all Capitalise debts. Therefore, from our perspective the proportion of debts made up of payday loans and other high cost unsecured loans has remained steady.

Amongst our Financial Health Exchange members and Capitalise partners, there is little direct evidence of people being refused a payday loan, but they have noted that they still see many clients who are being accepted for payday loans despite already having multiple loans.

Our stakeholders also noted it is often the long waiting periods associated with Universal Credit that triggers the need for payday loans or other sources of high cost credit. We feel it would be useful to better understand whether regional variations in high-cost short-term credit lending can be linked to the geographical roll out of Universal Credit. This is something the FCA may wish to analyse further.

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?

Our Financial Health Exchange members have explained that in many cases, customers will try to obtain credit through multiple providers at the same time, or may even pay broker fees, and this can lead to multiple approvals as credit applications registered with credit reference agencies are not real-time. This results in customers becoming over-indebted.

Other members have described that if a customer is declined for a loan, the need for the loan usually doesn't go away and they will likely go somewhere else to get it, depending on the need. If it is a white good they will usually go to companies like Bright House, which makes the loan seem even more affordable because of the focus on weekly repayment amounts rather than the total cost of credit. Other members have evidence that the rate of borrowing catalogue credit has gone up instead.

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

As already stated, repeat and multiple borrowing is a definite concern and we have touched on the issues and risks above.

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