FCA Practitioner Panel

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Dear David,

FCA Practitioner Panel response to call for input on High-cost credit including review of the high-cost short-term credit (HCSTC) price cap

The FCA Practitioner Panel members support the aims and approach of the work the FCA is undertaking in its review of the HCSTC price cap, and wider work on high-cost credit. It is important to understand the range of significant and unprecedented interventions in the HCSTC sector, and the results for consumers and firms, in the wider context of competition across credit product sectors, and alternative customer choices. It is equally important to continue to ground outcome reviews, analysis and any recommendations on robust and comprehensive data, while also remaining open to wider input and other valid sources of evidence. The FCA demonstrates its commitment to this continued approach in the call for input and associated evidence, demonstrating that its HCSTC interventions have been well-judged and effective.

Taking each of the questions that the FCA poses in the call for input in turn:

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?

The range of products listed by the FCA is comprehensive and appropriate for this exercise. The FCA is coming towards the end of a long and thorough first authorisation process for consumer credit firms, and has deployed a supervisory approach that focusses proactive attention where it is needed most. Therefore, the focus of this review should be on those product sectors that exhibit evidence of systematic consumer detriment that is not already being addressed through FCA authorisation and supervision of individual firms.

The rapid historic growth of HCSTC, and the nature and extent of new forms of consumer detriment evident, provided compelling evidence to many (including the FCA and the government) that swift, radical and unprecedented action was required. The resulting specialised sections of CONC, the expedited and rigorous authorisation process, and the implementation of a rate cap for the first time in the UK have evidently addressed the issues without eliminating the sector or consumer choice. If there are similar situations and evidence of detriment elsewhere, there may be an argument for a widening of the HCSTC interventions, and therefore a more consistent approach. However, consumers should expect a consistent quality of outcome first and foremost, whichever form of credit they choose. In the absence of evidence of similar detriment consistent with those in the early days of payday loans/HCSTC, any consistent application of the powerful HCSTC interventions is unjustified. Where there is evidence of consumer detriment, the nature of the issues and the most effective form of intervention should be considered carefully (as they were in HCSTC) so as to preserve the consistency of good outcomes for customers.

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

The FCA is evidently in the process of addressing cases of potential detriment in various product sectors through authorisation work with the small number of individual firms who remain on interim permissions. The FCA is also clearly still working with newly authorised firms through supervision on longer term issues and areas where it still has concerns over some elements of customer outcomes. On top of this work, thematic and market study work is ongoing in issues and sectors that have been identified as potentially problematic, with consultations on proposed actions imminent. Furthermore, the FCA continues to be advised by the Competition and Markets Authority (CMA) on actions it considers to be required, and areas for further investigation and use of the FCA's wider range of powers. Having moved on from successful intervention in HCSTC, the FCA's comprehensive view of the issues and multi-faceted ongoing approach to resolving them appears to be addressing any significant potential detriment remaining outside HCSTC.

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?

Under the new FCA regime, all consumer credit firms should be putting consumers at the heart of what they do and endeavouring to deliver good customer outcomes in the conduct of their business. Given the very wide range of credit product forms, and the significant change in nature of the regulation from statute to mainly a rules and principles based approach, it is inevitable that differences in interpretation of the requirements will occur. The FCA has shown itself to be effective in identifying and resolving firm failure to comply, through the initial authorisation gateway, and subsequently in ongoing supervision. Continued guidance and advice from the FCA to firms on what is expected in terms of compliance and outcome measures would help to minimise any issues beyond the inadvertent and human error. One of the benefits of a rules and principles based approach is the ability to quickly and efficiently adapt to matters that develop or become evident that sit outside the current rules, following appropriately well considered design and consultation processes.

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?

Any interventions should be tailored to the specific situation and product form, following a careful consideration of the competition and consumer implications, as was the case in the design of the HCSTC interventions. This approach will continue to avoid any significant unintended consequences for consumers or unwarranted distortion of competition.

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

The FCA presents robust evidence to show that the specific package of tailored HCSTC interventions were both justified and well-judged. The particular circumstances of the early rapid growth of a completely new payday lending product form prone to particular detrimental outcomes for many consumers dictated the form and extent of the interventions required. The results reported by the FCA demonstrate that much of the lending was not in the best interests of consumers in this case, and that the reduction in access to HCSTC observed is therefore largely positive. The FCA notes that 800,000 fewer borrowers used HCTSC, with little evidence of detriment through financial exclusion or lack of access to credit as a result in this particular case. This outcome is a result of both careful design, but also of the nature of the lending being conducted by payday firms, and the type of consumer they were serving. The FCA evidence tends to suggest that much of the lending was not essential or in the best interests of consumers, and that many of those declined as a result of the interventions did not lack access to (or have more issues with) credit thereafter. This combination of factors is not evident elsewhere in high-cost credit sectors where access to credit and financial exclusion are real issues, and borrowing is often for essentials. HCSTC protections applied more widely to sectors with more essential borrowing, or with consumers in more difficult situations, is likely to result in a very different outcome: lack of access to much needed credit, financial exclusion, consumer detriment and increased opportunities for illegal lenders.

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

The use of overdrafts is widespread and varied in nature and purpose, extending from prime customers to the non-standard market, with nearly half of all consumers using one at some point.

On one hand, overdrafts provide widespread and convenient access to the flexibility required to smoothly maintain a personal bank account and benefit from the convenience and price reductions available through automated payments. They mitigate the need to continually track payments and balances to ensure funds are available, and avoid the need to know the exact payment times and dates.

However, past work by the FCA and CMA suggests that some overdraft use is inadvertent and unintentional, and that consumers tend to be disengaged with both the price and the product itself as part of personal current accounts.

Overdrafts are therefore at times, and for some, a substitute for other high-cost credit products, but for others and in other circumstances they do not serve as an alternative.

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

Past work conducted by the CMA and FCA has identified the key issues with overdrafts. Markets work best for consumers when they are engaged, have understanding, control and visibility over choices and costs, and when many firms compete for their business under incentives that align well with the best interests of consumers.

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

The CMA has recommended a package of measures to address the issues that it found in the retail banking market, including overdrafts. On overdrafts, the CMA has encouraged the FCA to assess the effectiveness of the proposals for a Maximum Monthly Charge (MMC) and the level of customer engagement in general, with a view to improving both using its different perspective and range of powers where appropriate.

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*
- *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*

The FCA presents robust analysis based on comprehensive data on the pattern of, and reasons for, reduced applications and acceptance rates in HCSTC. FCA Practitioner Panel members have nothing to add.

It seems likely that lending in HCSTC will gradually increase as the sector continues to adapt to its new regulatory and competitive environment. Recent data published by the Consumer Finance Association (CFA) would appear to support this view.

The level and nature of the HCSTC price cap seems to have been well judged by the FCA in the specific situation of this sector, when combined with other interventions in setting new rules, authorising and supervising firms. This tailored package appears to have had the desired effect on firm behaviours, prices and costs to consumers, while preserving sufficient incentives for enough firms to continue to compete viably both online and on the high-street following the intended significant change in business models. It has neither been too lax as to have had little impact, nor too draconian so as to have eliminated the sector and the choice for consumers.

Contractual loan durations appear to have lengthened from the very short payday model, to more accurately match the realities of how the product was used and rolled over for a number of months, given customer circumstances. This appears to be as a result of intentional features in the design of the price cap and rules. The better match between contractual and actual loan durations results in better transparency and more predictable outcomes for customers.

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?

The FCA outlines robust evidence on actual outcomes using a comprehensive dataset showing that the risks of arrears for consumers using HCSTC has reduced significantly. FCA Practitioner Panel members have nothing to add.

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

The FCA reports robust evidence on actual outcomes using a comprehensive dataset showing little evidence that consumers are suffering any adverse consequences as a result of being declined for HCSTC. FCA Practitioner Panel members have nothing to add.

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

FCA Practitioner Panel member experience across a range of credit product types agrees with the FCA's conclusions based on a comprehensive credit reference bureau dataset that consumers do not generally move to other high-cost credit products as a result of being declined for HCSTC. There does not appear to be any distorting ‘waterbed’ effect on competition. The fall in HCSTC lending since around January 2014 has had no significant positive impact on member lending operations.

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

Longer loan durations in HCSTC are likely to be a positive move for consumers as many seemed to find the very short-term nature of payday loans hard to handle in reality. Combined with the inflexibility in repayment terms, a single month offered insufficient time for many customers’ circumstances to improve or short-term cash flow issues to be smoothed out by borrowing.

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?

See response to Q12 above.

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)?

The FCA appears to have been both vigilant and effective in identifying any efforts to evade the HCSTC price cap and rules, acting swiftly to eliminate such evasion. The definition of HCSTC is effective, striking a good balance between specificity and scope without constraining consumer choice unduly. There is real benefit in maintaining and actively monitoring the current simple and clear definition of HCSTC, rather than adding to its complexity in order to try to encompass all possible developments. Given the FCA’s wide range of powers and clear detailed view of the market, it has no need to do so.

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?

A balance needs to be struck in considering repeat and multiple borrowing.

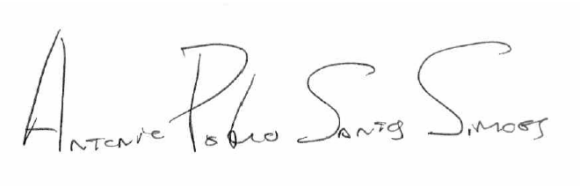
It is clear that the level and nature of past repeat and multiple borrowing in HCSTC was uniquely detrimental to customers. This included largely involuntary repeat borrowing as customers unable to repay at the end of the month, were forced to ‘roll-over’ loans. It also included many situations where desperate customers unable to repay one payday lender would borrow from another to meet their commitments in the short-term, without either lender being aware. The FCA presents robust evidence that intervention has proven effective in reducing multiple and repeat borrowing significantly in HCSTC, along with the detrimental effects thereof for consumers.

However, in general, and outside the specific excessive practices in early payday/ HCSTC, repeat and multiple borrowing behaviours generally reflect customer satisfaction, customer preferences and mutually aligned incentives with firms. Borrowers who are happy with their experience and the offers made to them, will continue to borrow from a lender, who will benefit from lower customer acquisition costs due to the loyalty earned, enabling them in turn to make more attractive offers. Customers also benefit from lower search and selection costs, and build up a productive relationship of mutual trust with firms they use based on their experience. Customers also often want to borrow separately for separate needs (compartmentalising their finances) or to maintain lines of credit with different lenders to keep their options and choices open in the future to remain in control. This is especially the case in the non-standard credit market where continued access to legal credit cannot always be taken for granted. Therefore the desirability of multiple and repeat borrowing depends crucially on the context and the ultimate customer outcome. In any case, high quality and up to date credit reference bureau data is essential to ensure that all lenders are fully aware of the situation of each borrower when making decisions.

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

FCA Practitioner Panel members have nothing to add.

Yours sincerely,



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