David Malcolm
Strategy & Competition,
Financial Conduct Authority
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Canary Wharf
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15th February 2017

Dear David,

FCA Smaller Business Practitioner Panel response to call for input on high-cost credit

The Panel is pleased to respond to the call for input on high-cost credit. We have supported the introduction of the high-cost short-term credit price cap. Our principal message is, however, that a one-size-fits-all approach to the high-cost credit market is not appropriate and that the FCA's approach to regulation should take into account the specificities of different types of business within the sector.

In answer to specific questions:

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?

We believe the scope of the review is sensible, and that the focus should be on any product sectors with systemic customer detriment issues that the FCA is not already addressing through authorisation and supervision. Consequently, we consider that greater consistency of approach across the high-cost credit market is neither desirable nor feasible due to the variety of products and the lack of any evidence of the same sorts of issues that arose in high-cost short-term credit (HCSTC) and drove the need to intervene.

Having acted swiftly and decisively to alleviate the systemic consumer detriment in HCSTC, the FCA will now be aware through authorisation supervision that there are no other widespread issues in high-cost credit that are not already being addressed through those means.

The firm-specific action being widely pursued by the FCA is the appropriate response to the issues that remain in the wake of the restructuring of HCSTC.

HCSTC was a very specific case of rapid growth and unjustified lending, the removal of which has left 800,000 fewer borrowers but with little evidence (according to the FCA) of detriment through financial exclusion or lack of access to credit – this 'bubble' nature of HCSTC with which the FCA has dealt is not evident elsewhere in high-cost credit and therefore the risks of detriment to customers through exclusion outside HCSTC are significant were the FCA to intervene.

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

CMA and previous evidence suggests that overdraft use is largely inadvertent and unintentional – consumers are highly disengaged with both the price and the product – suggesting that overdrafts largely sit in their own separate market and type of usage.

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

and

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

Unauthorised overdrafts and the practices adopted by some banks for charging for this service means that some consumers are paying very high fees that would equate to exceptionally high APR equivalents. A monthly maximum charge is a much better approach. Banks should also be encouraged, in some circumstances (where consumers are more vulnerable) to remove the unauthorised overdraft facility entirely so that consumers must make contact and arrangements for a more affordable line of credit from their bank. Additionally, banks and current account providers can and should be mandated to do more at sign up stage about the costs and implications of accessing funds via an unauthorised overdraft. There should be clear pricing information at regular intervals.

Some credit use for short term needs is planned and well considered by consumers, so for these situations overdrafts are a closer substitute for other forms of credit including HCSTC. Some overdraft balances are eventually moved to other credit products, but the degree of initial and immediate substitutability between overdrafts and other forms of credit is limited.

We have reservations about the introduction of a new way of measuring price (MMC) in overdrafts when others exist. We suggest simply using the APR figure. Consumers already recognise the APR and despite its flaws it can allow comparison across similar credit forms on a sensible basis. Although it is true that consumers do not understand the calculation process for the APR, this is irrelevant. It is complicated in design, but simple in use for consumers – they just choose the lowest figure for any form of credit.

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 analysis on the reasons for the declines in HCSTC applications and approvals appears robust, along with the conclusion that the regulatory intervention has driven positive changes in the market to ensure that the best interests of firms and their customers are aligned i.e. making good lending decisions and customers paying back their loans was a good outcome for both. It seems likely that the HCSTC market will neither die nor grow as rapidly as in the past, therefore it is likely that measured growth in applications and approvals should be expected

HCSTC rules and price cap have evidently seriously impacted firm business models in the sector, but have allowed many to survive, some retaining profitability, and therefore the continuation of a viable market should be expected in the absence of further tightening of interventions.

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 presents compelling evidence that the risks to the use of HCSTC and arrears have significantly reduced and that outcomes have improved for customers, therefore we query whether the requirement for a HCSTC risk warning on adverts is still justified

The FCA presents compelling and complete data and analysis that consumers are not suffering adverse consequences with legal credit that is reflected in the credit reference bureau data as a result of being declined for HCSTC.

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

Friends and family lending will be an important part of the solution for some declined HCSTC customers, which will not be captured in the credit reference bureau data, and may result in different forms of consumer detriment not readily observable

As the FCA says, understanding changes in illegal lending is very difficult, but given the demographic profile of HCSTC borrowers, and the excess level of lending removed by intervention, it is not perhaps surprising that illegal lending has not increased as a result in HCSTC.

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

The overview of the call for evidence (para 1.6) states there has been a discernible decrease in acceptance rates and declining default rates in the HCSTC sector, and goes on to say that there has been an average increase in loan duration. We would like to see any evidence is there that people are just not borrowing, if declined. More research needs to be done to ensure consumers are not going to alternative lenders (at best other high cost lenders e.g. doorstep lenders, and at worst illegal money lenders). We also suggest it would be beneficial for the FCA to carry out further research into whether, if default rates are dropping, consumers are defaulting on commitments other than HCSTC to keep that line of credit open. For example, are consumers taking out HCSTC showing any increased levels of default in rent, mortgage, utility bills etc, in order to service credit payments?

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 credit markets, such as car finance, go through significant cycles and therefore any assessment of outcomes for firms or consumers should be considered in the longer term - over 10 years, the returns have not been high on average.

Some credit markets such as the car finance market are highly fragmented, so any intervention including price caps will be very hard to implement, without the risk of unintended consequences. In car finance in particular, personal contract hire is a substitute product that would not be easy to regulate in the same way as credit products.

Yours sincerely,

Clinton Askew
Chair, FCA Smaller Business Practitioner Panel