Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: PS19/6: Rent-to-own price cap

Lead regulator: FCA

Date of assessment: 05/02/2019

Commencement date: 01/04/2019

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? Whole of UK

Brief outline of proposed new or amended regulatory activity

Rent-to-own (RTO) retailers offer household items, such as washing machines and televisions, in-store and online, with consumers making weekly payments. Consumers hire the goods for a period of up to 3 years under a hire-purchase agreement. They can then choose to take over ownership of the goods when they have made all the payments.

We found evidence of vulnerable consumers paying high total costs in this market compared to other retailers' prices.

We want to bring down prices on RTO agreements where the overall costs to consumers are high compared to other retailers' prices. We proposed to do this by:

- setting a total credit cap of 100%
- introducing a requirement that firms must benchmark product base prices (including delivery and installation, but excluding any add-on products like warranties etc) against retail prices
- preventing firms increasing their prices for other goods and services sold with an RTO agreement – for example, theft and accidental damage cover, extended warranties, or arrears charges - to recoup lost revenue from the price cap.

Which type of business will be affected? How many are estimated to be affected?

The price cap will affect any firm entering into RTO agreements. We estimate that around 20 firms will be affected by the price cap. Firms are not required to tell us that they are undertaking RTO activity, so this estimate is based on our knowledge of consumer credit markets, regulatory reporting data and desk research.

There are two large firms in the RTO sector. Together, they account for over 90% of the outstanding balances on RTO agreements. The largest three firms account for over 95% of outstanding balances.

We expect non-RTO retailers (and some consumer credit providers potentially) to benefit from consumer switching.

Price base year	**Implementation date**	**Duration of policy (years)**	**Business Net Present Value**	**Net cost to business (EANDCB)**	**BIT score**
2018	2019	10	-224.9	26.1	130.5

Please set out the impact to business clearly with a breakdown of costs and benefits

All costs and benefits set out below are taken from our Consultation Paper (CP18/35). Unless otherwise stated, they affect RTO firms and are industry-wide.

Loss in net revenue (ongoing costs of £29.2m p.a., £23.6m in the first year)

We simulated the effects of benchmarking of base prices and the total cost of credit cap on firms' gross and net revenues using agreement-level data from the two largest firms in the market. Because RTO firms sell the products as well as providing the financing, "gross revenue" includes all payments made on the agreements. Net revenue was calculated as gross revenue minus the cost of goods sold. The value of returned items was accounted for using straight-line amortization over the term of the agreement.

We estimate that gross revenue for the RTO sector falls by around £32.9m per year. There is a smaller impact on the net revenue of RTO firms (as measured by the difference in revenue and the costs of the good).

We would expect the actual fall in revenues to be lower than we estimate for two reasons.

1. Firms are required to apply affordability assessments which prevent some consumers who could profitably be lent to from accessing an RTO agreement. The lower prices (and weekly repayments) will mean that some of these agreements become affordable where previously they were not, thereby expanding the pool of potential customers. These consumers would be accepted for RTO agreements where previously they would not have been.
2. On the demand side, we would expect lower prices to attract more consumers to apply for RTO agreements, leading to additional sales. We do not think it is reasonably practicable to estimate these effects as we would have to estimate the price elasticity of individual products. This is because firms sell several thousand products per year. Further, we may not see enough price variation in products to enable such analysis to be robustly undertaken. We have not quantified these additional sales and the associated revenue that firms would earn under the cap.

We also note that our analysis will slightly overstate the loss in net revenue. This is because we have not accounted for all the other costs associated with particular sales, apart from the costs of goods sold. For example, there will be some additional costs to setting up and managing agreements that we have not accounted for in the analysis. Neither have we accounted for funding costs for individual agreements. This is because it was not possible to measure the cost of capital for firms given the changes in the market. This also overstates the loss of net revenue for firms. That is, we overestimate the costs to firms.

We expect around half of the small firms in the market to be affected by the cap and therefore lose revenue as a consequence of the proposed cap. These estimates are included in our estimate presented above.

The rules apply for new products from 1st April 2019, while the rules apply to existing products from, either, the point the RTO firm raises the price or 1st July 2019 (whichever date is sooner). The rules will apply for micro-enterprises from 1st October 2019[1]. We estimate that around 15% of sales are on products brought to market per quarter. Hence, the revenue loss, and the cost to firms from the cap, is £5.6m lower in the first year.

Benchmarking (ongoing costs of £310k p.a. and one-off costs of £160k)

The proposal would mean that firms would be required to set base prices so that they reflect the price of the same or similar goods charged by other retailers. To estimate these costs, we assume that each firm benchmarks their products against the same or comparable products available at 3 retailers.

Using information from the two largest retailers, we find that on average each RTO firm sold around 2,500 different products in 2017. We also assume the third largest firm offers a similar range of products. Also, in our pricing analysis of firms, we found that smaller firms typically have a smaller range of products and will need to benchmark fewer products. We assume that on average these retailers sell around 1,000 different product types each year.

Given that firms will need to update their benchmarking every year for products that they continue to sell, or benchmark products that replace those they stop selling, these firms will need to benchmark 1,000-2,500 products each per year.

We expect that retail buyers at these firms would each benchmark the products for which they are responsible. We estimate that it would take a maximum of 15 minutes for each product to be benchmarked and for the record of this benchmark to be retained. This estimate is based on the time taken for similar analysis undertaken by the FCA to inform the development of the cap.

We acknowledge that there will be significant variance in the time taken to benchmark these costs. Furniture, which is typically more bespoke, may take longer to benchmark. However, other product categories are more widely available and therefore benchmarking will take less than 15 minutes.

Using public information on the salaries of retail buyers, we use an upper bound salary of £60,000 per year. Assuming that retail buyers would work on average 220 days per year, 7 hours per day and there are overheads of 30% (such as pension costs, National Insurance, allowances and other benefits), we estimate that it costs around £13 to benchmark each product. We therefore estimate industry-wide benchmarking costs of around £310,000 per year.

We also assume firms incur half these costs in the first year at £160,000 as they will need to benchmark some products that are only on sales for a shorter period of time.

Familiarisation and gap analysis (one-off costs of £10k)

We estimated that there would be 71 pages of policy text and 10 pages of legal text. We used standard assumptions on:

- reading speed (100 words per minute)

[1] This is in recognition of the limited resources of micro-enterprises.

- the number and salaries of compliance staff by size of firm (5 at larger RTO firms (£60 p.h.), 2 at small firms (£43 p.h.))
- the number and salaries of legal staff by size of firm (2 at larger RTO firms (£66 p.h.), 1 at small firms (£52 p.h.))

IT changes (one-off costs of £260k)

We would expect firms to incur costs in updating their IT systems to implement the price cap. We used our internal standardised costs model to make assumptions to estimate these costs for the 20 firms in the RTO sector. We do not expect firms to have to make large scale IT changes to comply with the cap. However, we do expect firms to have to update systems to implement the cap and maintain records of how they have set fair base prices for all of their products.

One-off IT costs are estimated using research on the structure of IT projects. We assume that the three large RTO firms each use 156 days of staff time from staff in 6 different roles to update their IT systems to implement the price cap, across a project lasting 40 days. Using salary information from Willis Towers Watson 2016 UK Financial Services Report, we calculate that these changes will lead these three firms to incur costs of £56,000 each.

Additionally, we would expect the remaining smaller firms to incur some IT cost. We would expect that these firms would use fewer than 20 days of an IT professional to update their systems. We estimate the total costs to all smaller RTO firms to be up to £5,000 each.

In total, we expect one-off IT costs of around £260,000.

Governance and change (one-off costs of £340k)

These costs assume that firms, particularly the large firms, will set up project teams to implement the price cap, revise internal processes and develop policies. We expect that the larger firms would on average spend 280 days to deliver the changes required of the business to meet the cap. The time is spread across project teams and executive and board oversight. We would expect in practice that firms would incur less time in developing their compliance with cap. Using public salary information, we estimate the average cost of the large three firms to be £100k per firm.

For smaller firms, we expect the costs to be much less. We expect firms on average to devote 6 days. We again use Willis Towers Watson 2016 UK Financial Services Report to estimate the salaries of staff implementing these changes to estimate a cost per day of around £300 per day, which would lead to a cost of £2,000 per firm.

In total, we expect firms to incur one-off costs of managing the changes required as a result of the cap of around £340,000.

Total ongoing costs to firms of £29.5m p.a.

Total one-off costs to firms of £900k

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

We have made changes to our final rules since consulting. The changes we have made to requirements on benchmarking of new products and bundles of products will enable firms to continue offering new products and bundles of products, albeit with some changes in firms' processes. We do not expect the time taken to benchmark products has changed materially from what we estimated in the CP. The changes we made ensure that when benchmarking firms used prices that a reasonably informed consumer would pay. These amendments align the proposed rules with our policy intent that we set out in CP18/35. This intent was the basis on which we undertook the CBA. Allowing micro-enterprises additional time to comply would make only a marginal impact on the overall costs and benefits of the policy. Our assessment of costs and benefits therefore remains the same.

Rent-to-own and alternatives to high-cost credit – feedback on CP18/12 and consultation on a price cap - https://www.fca.org.uk/publication/consultation/cp18-35.pdf
Rent-to-own price cap – feedback on CP18/35
and final rules - https://www.fca.org.uk/publication/policy/ps19-06.pdf