Financial Conduct Authority

Consultation Paper CP17/10

Credit card market study: consultation on persistent debt and earlier intervention remedies

April 2017

Contents

We are asking for comments on this Consultation Paper by 3 July.
You can send them to us using the form on our website at:
www.fca.org.uk/cp17-10-response-form

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We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this Consultation Paper from our website: www.fca.org.uk.

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Abbreviations used in this document

APR	Annual percentage rate of charge
CCMS	Credit card market study
CBA	Cost benefit analysis
CCJ	County court judgement
CRA	Credit reference agency
CMA	Competition and Markets Authority
CONC	Consumer Credit Sourcebook
CP	Consultation Paper
EU	European Union
FCA	Financial Conduct Authority
FLA	Finance and Leasing Association
HCSTC	High-cost short-term credit
FSMA	Financial Services and Markets Act 2000
LRRA	Legislative and Regulatory Reform Act 2006
LSB	Lending Standards Board
PSD2	Payment Services Directive 2
UCLI	Unsolicited credit limit increase
UKCA	UK Cards Association

1. Overview

Introduction

1.1 In this Consultation Paper (CP) we set out proposals for new rules and guidance to address persistent credit card debt and to require firms to assess whether customers are at risk of developing financial difficulties, and intervene appropriately.

1.2 We also set out the way forward in relation to control over credit limit increases.

1.3 These interventions form part of the overall package of remedies announced in July 2016 in the credit card market study (CCMS) final findings report[1]. The overall objective of the package as a whole is to reduce the number of customers with problem credit card debt. In particular, we are setting out proposed new rules about the treatment of customers whose debt persists over 18 to 36 months.

The credit card market study final findings

1.4 In the CCMS final findings report, we said we had found that competition was working fairly well for most of the 30 million consumers who hold one (60% of the adult population) but that we had significant concerns about the scale, extent and nature of problem credit card debt and firms' limited incentives to reduce this.

1.5 For example, we found that in 2014, around two million people (almost 7% of credit card customers) were in arrears or had defaulted. In exploring potential issues in the credit card market as we refined our thinking on remedies, we identified that a further two million people had carried a debt greater than 90% of their credit limit for at least 12 months, and that an additional 1.6 million people were repeatedly making minimum payments on their credit card debt. We also identified that nearly 5.1 million accounts active in January 2015 (9%) would (on current repayment patterns and assuming no further borrowing) take more than ten years to pay off their balances.

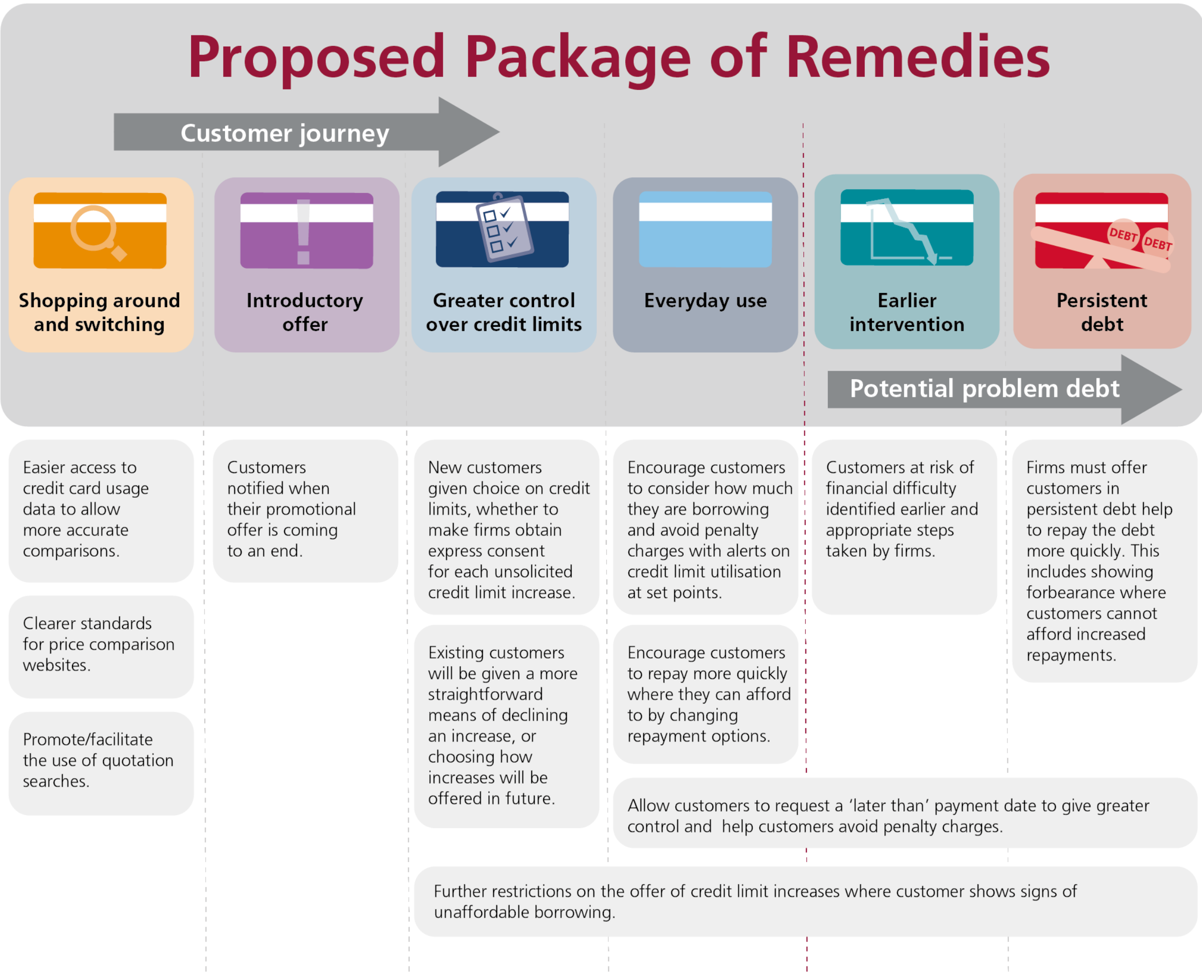
1.6 Many customers with high balances, or those making minimum repayments, did so for a number of years. In the CCMS dataset, around 650,000 customers had sustained a balance over 90% of their credit limit for at least three consecutive years; a further 750,000 customers had been making systematic minimum repayments for at least three consecutive years. As many credit firms point out to customers, credit cards are suited to short-term borrowing and can be an expensive way of borrowing large amounts over an extended period.

1 https://www.fca.org.uk/publications/market-studies/credit-card-market-study

1.7 While these findings deepened our concern about the scale and persistent nature of some customers' credit card debt and firms' lack of incentives to tackle it, we said in the final report that we would give full consideration to the thresholds for applying any remedy, and recognised that not all customers with high credit utilisation or long-term minimum repayments were necessarily in financial difficulty. To focus our proposed interventions more closely on customers about whom we have concerns, we have developed a different definition of persistent debt than that used in the final report. This new definition is focused on capturing the customers for whom this persistence is most likely to be very costly and who may have underlying financial difficulties; namely those who are repaying less in principal[2] than interest and charges over a period of 18 months. We explain in detail why this definition is appropriate in Chapter 2, and in the cost-benefit analysis in Annex 2.

Our overall package of remedies

1.8 In the final findings report, we set out proposals for a package of remedies designed to address the issues that we identified during the market study.



2 We use 'principal' to describe the amount of credit drawn down by the customer under the credit card agreement; it does not include any interest, fees or charges added to the account.

1.9 The overall objective of the package is to reduce the number of customers in problem credit card debt and to put consumers in greater control of their borrowing. The package includes interventions that cover the life cycle of a credit card, from shopping around and switching to everyday use of the card, through to the circumstances when a customer develops problems (such as persistent debt).

1.10 We think the overall package is robust, and that the combined effect will be to address the concerns identified in the CCMS and, taken together, will positively impact the way credit cards are used.

1.11 While retaining the flexibility of this product, which is valued by millions of customers, we believe this package will:

- reduce the use of credit cards to service interest-bearing debt over a long period
- encourage faster repayment where it is affordable
- reduce over-borrowing
- help customers avoid unnecessary charges
- give customers greater choice about how their credit limit is managed, and
- improve customers' awareness of the expiry of promotional interest rate periods

1.12 The package is designed to achieve this by:

- incentivising customers and firms to avoid persistent debt, which we expect to impact four million accounts and in due course help two million account holders repay their credit card debt more quickly, including requiring forbearance for those who cannot afford to repay faster
- requiring firms to use relevant data to identify customers at risk of financial difficulties, and to take appropriate action
- prompting customers at key points to avoid incurring unnecessary costs by not switching at the end of promotional offers or exceeding credit limits
- enabling customers to request to move their payment date
- giving customers choice about how they receive offers of credit limit increases and making it easier to express their preferences, and
- stopping some customers at risk of potential unaffordable borrowing from receiving offers of credit limit increases

1.13 This package is being delivered through a combination of rules and voluntary industry remedies. Progress and compliance with the latter will be overseen by the Lending Standards Board (LSB)[3], and we will monitor outcomes with a view to considering whether this approach is working well in due course.

3 The Lending Standards Board is an industry self-regulatory body.

1.14 This CP proposes a way forward on persistent debt, earlier intervention to identify customers at risk of financial difficulty and take appropriate action, and announces the industry voluntary remedies to give greater control over credit limit increases. Before explaining these we briefly summarise the other elements of the package: the information remedies to help customers avoid unexpected interest and charges, and the work – currently the subject of behavioural trials – on minimum repayment behaviour. We also summarise other relevant ongoing work.

1.15 As announced in the final findings report, the UK Cards Association (UKCA) acting on behalf of the credit card industry have voluntarily agreed three information remedies, which will see firms:

- inform customers that their promotional offer is coming to an end
- notify customers when they are close to their credit limits to help avoid penalty charges, and
- allow customers to request a 'later than' payment date to give greater control and help them avoid penalty charges

1.16 The timelines for the industry agreement implementation have now been agreed and will be in place:

- promotional rate expiry: April 2018
- payment date changes: April 2018
- close to credit limit prompt: July 2018

The first two remedies will have an interim implementation rate of 95% in January 2018.

1.17 We are currently carrying out behavioural trials with a number of credit card firms to test the effect of different ways of presenting repayment options, with the intention of finding ways to encourage people making low repayments to repay more where it is affordable for them. Once the trials are complete, we will consider the results and the most appropriate way to achieve the outcomes we are seeking. This may include options such as changes to how repayment options are presented to customers, or increases to minimum repayments. More detail on the behavioural trials can be found in Chapter 5.

1.18 We have already begun work on a number of other interventions that will impact the credit card market, such as:

- implementation of the second Payment Services Directive (PSD2) to allow easier access for customers to their credit card usage data for more accurate comparisons
- contributing to the Competition and Markets Authority (CMA)'s work on digital comparison tools[4]
- we have welcomed a piece of cross-sector work being undertaken over the next year by the British Bankers' Association, the Finance and Leasing Association (FLA) and the UKCA to further examine quotation search tools. The industry continues to develop this piece of work which will:

4 https://www.gov.uk/cma-cases/digital-comparison-tools-market-study

- assess the extent to which recent innovative market developments facilitate the ability for consumers to shop around
- identify areas where further enhancements may be helpful for customers. For example, opportunities to develop some industry standards for using quotation search tools and raising awareness of these tools among consumers

The industry plans to consult relevant stakeholders on this in due course, taking into account wider related developments such as the CMA's market study into digital comparison tools.

1.19 As noted in Annex 1 of the CCMS final findings report, a number of respondents to the interim report drew attention to an issue regarding credit card firms' offers of 0% introductory periods for purchases and balance transfers. Since then we have taken supervisory action in a number of cases where we found firms' financial promotions for such offers did not make clear that the length of the introductory period was subject to a customer's status, and as such was not available in full to all customers whose applications were accepted. Following our action, the firms in question amended their promotions to make this much clearer.

1.20 We would like to take this opportunity to remind firms that there are a number of relevant rules in this area, including the high level requirement that financial promotions must be clear, fair and not misleading. Firms must also ensure that each communication and financial promotion is presented in a way that is likely to be understood by the average member of the group to which it is directed and does not disguise, omit, diminish or obscure important information or statements. In relation to APR, our rules require that at least 51% of customers should be expected to be charged the representative APR or better.

1.21 In our view it should be obvious to firms that financial promotions for credit cards with 0% introductory periods should represent a genuine offer, and make clear, if it is the case, that the advertised period is a maximum and that shorter periods may be offered to customers depending on their circumstances. We would have concerns if the headline rate or period were not available to a significant number of consumers or if any limitations on its availability were not made clear. This is an area where we will undertake further work during the course of the year to look at the issue and consider the case for additional rules or guidance if necessary. If we decide to propose new rules and guidance we would consult on this alongside any proposals on changing repayment options, as discussed in Chapter 6.

1.22 Separately, we are also undertaking work on how firms across the credit sector generally conduct creditworthiness and affordability assessments.

1.23 The remedies set out in this CP are limited in scope to the credit card market as they are aimed at addressing the specific concerns identified in the CCMS. The FCA is doing wider work to look at different areas of credit. For example, in November 2016 the FCA published a call for input on high-cost credit, including a review of the high-cost short-term credit (HCSTC) price cap[5]. We intend to publish a feedback statement in summer 2017 in which we expect to set out our plans for further work in this area. We are however mindful that interventions need to be carefully considered and, while lessons can be learnt looking across interventions in different areas of credit, we must consider properly their individual features – for example their different constituent product features and the customers they serve.

5 https://www.fca.org.uk/publications/calls-input/high-cost-short-term-credit-price-cap

Summary of our proposals on persistent debt and earlier intervention

1.24 In this CP, we propose new rules and guidance in relation to persistent credit card debt and earlier intervention.

Persistent debt

1.25 The flexible nature of credit cards is one of their most positive features – in allowing customers to repay at the rate that suits them, subject to a minimum repayment, credit cards allow for a more flexible repayment schedule than, for example, a personal loan. However, this makes it possible to sustain credit card debt over a long period of time without making significant repayments. This will typically incur significant costs of borrowing.

1.26 For example, a customer with a £3,000 debt on a credit card with an Annual Percentage Rate of Charge (APR) of 19%, who is repaying as much in interest and charges as in principal would take almost 20 years to repay the debt. They would pay £2,900 in interest over that period.

1.27 We believe that some customers deliberately choose to repay slowly, while others do so without giving this much thought. Some customers are simply unable to repay more quickly.

1.28 Firms have few incentives to address customers with persistent debt as these customers are profitable; we found that most firms do not routinely intervene to address this behaviour. Our proposal intends to rebalance incentives so that both firms and customers are encouraged to avoid credit card debt becoming persistent, and customers who cannot afford to repay more quickly are given help.

1.29 In order to deliver the appropriate assistance for customers in persistent debt, we are proposing the following:

- A definition of persistent debt that identifies customers paying more in interest and charges than principal over an 18 month period

- Our analysis shows that during the period covered by the CCMS dataset there were around 4 million accounts in persistent debt at any given time

At 18 months:

- Customers in this situation would be made aware that increasing their current rate of repayment would reduce their cost of borrowing and the time taken to repay. They would be informed that continuing low repayments for a further 18 months may mean the firm suspends use of the card and makes a report to a credit reference agency (CRA)

At 27-28 months:

- If customers' repayments up to this point indicated they were likely to remain in persistent debt at the 36 month point, firms would be required to repeat the steps required at 18 months

At 36 months:

- If customers are still in persistent debt after a further 18 months, and thus have repaid more in interest and charges than principal for two consecutive 18 month periods, firms must take steps to help them repay their outstanding balances more quickly. They must write to the customer proposing options for repayment plans, based on repaying their debt over a reasonable period, usually between three and four years. The customer would be made aware that their use of the card will be suspended unless they engage with the firm

- Where customers inform the firm that they cannot afford any of the proposed payment options to repay the debt within a reasonable period, firms must exercise forbearance to assist the customer to repay the debt more quickly. This may include a reduction in the interest rate being charged

- Where forbearance is shown, we expect it will generally be necessary for the firm to suspend the use of the card

- Customers who confirm they can afford to make increased repayments but decline to do so, and customers who do not respond to the firm, would have their use of the card suspended or cancelled

- The interventions would continue until the customer has repaid the balance they had at 36 months

- Based on the CCMS dataset, our analysis suggests there are around 2.2 million accounts in persistent debt for two consecutive 18 month periods at any given time

1.30 The nature of forbearance, where required, is not prescribed, but it should have the aim of assisting the customer to repay the balance in a reasonable period, and may include reducing, waiving or cancelling any interest or charges to the extent necessary for the customer to be able to repay their balance in a reasonable period.

1.31 The 2.2 million accounts that in December 2014 had been in persistent debt for two consecutive 18 month periods had an outstanding debt of £7.8 billion (£3,624 per account). Accounts in persistent debt under our proposed definition are typically paying approximately £2.50 in interest and charges for every pound of their balance they repay.

1.32 We estimate that the proposals will lead to savings for consumers from lower interest payments, which will be reflected in lower revenues for firms. We estimate that the total cost savings are expected to be within the range of £3 billion to £13 billion up to 2030. We anticipate that this will peak at between £310 million and £1.3 billion per year.

1.33 This approach is intended to rebalance incentives on firms and customers. We expect firms will want to encourage customers to repay more quickly to avoid the costs of the 36 month intervention, and that customers will want to retain use of their card where possible.

1.34 We consider that the scale of persistent debt identified among existing credit card customers creates a strong argument for swift commencement of the rules after they are made; we would not wish there to be a period of 18 months following the rules being made before the first customers receive notifications from firms. As such, we propose that firms will have to comply with the rules three months after they come into force. This means that on this date firms would have to assess which customers have been in persistent debt for the previous 18 months. This period would include the 15 months before the rules came into force. The proposed implementation timetable also means that the first '36 month' interventions will occur 21 months after the rules come into force.

1.35 Full details of our proposals on persistent debt and the expected impact can be found in Chapter 2 and the cost benefit analysis (CBA) in Annex 2.

Earlier intervention

1.36 We are also proposing to build on an existing rule that requires firms to monitor a customer's repayment record for signs of actual or potential financial difficulties. Credit card firms will often have in their possession more data than a customer's repayment record (for example, their spending patterns, changing repayment behaviour, county court judgements (CCJs), and CRA data) and so we propose that firms must:

- use the data they hold to assess whether customers are at risk of potential financial difficulties
- take appropriate action, and
- establish, implement and maintain an adequate policy for dealing with customers showing signs of actual or possible financial difficulties, even though they may not have missed a payment

1.37 The earlier intervention and persistent debt remedies are designed to work together and complement each other. In practice, some customers who are subject to persistent debt interventions may experience worsening financial circumstances that could be identified under the earlier intervention rules. Similarly, a customer identified under the earlier intervention rules may also subsequently enter persistent debt.

1.38 The proposals on persistent debt are also designed to work together with existing rules on forbearance under CONC 7.3.4R and our earlier intervention rules. Where customers are already being shown forbearance or treated more favourably than they would be under the requirements of the intervention at the 18, 27 or 36 month stages, firms would not be required to implement those parts of the intervention. We explain this in more detail in Chapter 2.

1.39 Full details of our proposals for earlier intervention can be found in Chapter 3.

Control over credit limit increases

1.40 We are also using this CP to describe the voluntary remedies the industry will adopt to give customers greater control over their credit limit.

1.41 The industry,[6] in discussions facilitated by UKCA, has agreed the following:

- New customers will all be given the choice of how credit limit increases will be applied to their account. They may choose either not to receive a credit limit increase unless they expressly accept it (opt in), or to have a credit limit increase applied on their account automatically unless they decline it (opt out). Customers who do not make a choice will be offered credit limit increases on an opt in basis by default.
- Existing customers will be offered a more straightforward means of declining an offer of a credit limit increase, as well as the choice of having any future offers made on an opt in basis.
- All customers will be made aware of their existing right to choose to no longer receive credit limit increase offers.
- All customers will still be able to ask for a credit limit increase at any point.

6 This includes the vast majority of firms currently offering credit cards in the UK.

1.42 In addition, credit card firms, following discussions facilitated by UKCA, have undertaken to make changes to how they offer unsolicited credit limit increases (UCLIs) to customers who are making systematic minimum repayments. After eight months of making minimum repayments customers will not receive a credit limit increase unless they expressly opt in (and the other requirements, including in relation to the credit worthiness assessment, are met). After 14 months of minimum repayment, customers will no longer receive UCLI offers.

1.43 In addition, where customers have high credit limit utilisation over an extended period, firms will not be permitted to increase the limit of a customer without the customer's express agreement. The detail of these metrics will be subject to further discussion in the light of our proposals in this CP.

1.44 Ongoing monitoring of the industry agreement will be overseen by the LSB.

1.45 These changes will affect all customers who take out new cards and existing cardholders who are offered a credit limit increase. Full details of the industry's commitment can be found in Chapter 4.

Who does this consultation affect?

1.46 This consultation affects firms that offer credit cards to consumers.

1.47 Our proposed rules will also affect consumers who hold credit cards, specifically those who carry a balance over a long period of time without making significant repayments, and customers at risk of financial difficulties.

1.48 It will also be of interest to consumer representative organisations and firms who provide debt advice.

Equality and diversity considerations

1.49 We have considered the equality and diversity issues that may arise from the rules on which we are consulting in this CP.

1.50 Overall, we do not consider that the proposals adversely impact any of the groups with protected characteristics – i.e. age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

1.51 As the proposals primarily focus on delivering appropriate assistance to customers who are likely to be in financial difficulties, or at risk of developing them, vulnerable consumers in general will benefit from our proposals.

1.52 We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when publishing the final rules.

1.53 In the interim, we welcome any input to this consultation on such matters.

Next steps

1.54 We want to know what you think of our proposals. Please send us your comments by **3 July**. Use the online response form on our website or write to us at the address on page 2.

What will we do?

1.55 We will consider your feedback and take it into account in developing our rules. We expect to publish our rules in a Policy Statement once we have completed this process.

2. Persistent credit card debt

In this chapter we explain the problem we are seeking to address with our proposed persistent debt intervention, and how our proposals will help deliver the most appropriate assistance to customers.

Introduction

2.1 One of the key features of credit cards is that customers can decide how quickly they repay their balance, choosing whether to repay it in full at the end of each month or to spread payments over a longer period. Subject to a contractual minimum repayment[7], customers can choose how much to repay each month. Any spending on the card reduces the remaining credit available and repayments make credit available again. Combined with the convenience of card-based payments and various reward points and other loyalty schemes, this flexibility is a large part of what makes credit cards such a widely used and popular product with 64 million credit cards currently in issue[8].

2.2 However, the flexible nature of credit cards and the lower minimum repayment, in comparison to a personal loan for the same sum, means that it is possible for customers to carry a large balance for a long period of time without significantly reducing their debt. The ability to make minimum repayments for a period is one of the flexible features of credit cards valued by many customers, but where the customer has an interest-bearing balance over a long period of time this can be a very expensive way of borrowing in comparison with other credit products. For example, a customer with a £3,000 debt on a credit card with an APR of 19%, who is repaying as much in interest and charges as in principal would take almost 20 years to repay the debt. They would pay £2,900 in interest over that period.

2.3 Holding a credit card balance for an extended period can also be a sign that a customer may be trapped in a cycle of borrowing which they cannot afford to pay down. In some circumstances, a customer making the monthly minimum repayment may have underlying financial difficulties which are obscured by the repayment pattern.

2.4 Many firms explicitly point out to customers that credit cards are not intended for repaying interest-bearing debt over a long period and that doing so may be a very expensive way of borrowing. For example, firms' adequate explanations and 'key facts' documents often include phrases such as "It's important you try to pay your balance in full every month," and

7 The minimum repayment must be at least 1% of the balance plus any interest and charges incurred that month, or £5 – whichever is greater. Some firms have implemented higher contractual minimum repayments and some credit agreements entered into before the introduction of the minimum repayment requirement may have a lower requirement.

8 UK Cards Association 'Summary of key statistics for Q3 2016': http://www.theukcardsassociation.org.uk/wm_documents/Quarterly%20Market%20Trends%20Q3%202016%281%29.pdf

"Depending on what you want to use the credit for, there may be cheaper ways to borrow." Where customers do borrow over a long period, however, firms rarely intervene.

2.5 There are a number of reasons that a customer is in persistent debt. Some customers may have deliberately chosen to repay at a very slow rate; others will have done so without giving it much thought. Some customers in both groups will be repaying as quickly as they are able to afford. Given the comparatively high cost, it is unlikely that customers in long-term persistent debt would be doing this as a deliberate strategy. Once in persistent debt, customers fall into two broad groups regarding repayment at a faster rate: those who can afford to do so and those who cannot.

2.6 In the CCMS final findings we said that we were concerned about the scale and size of balances on credit cards that were being repaid slowly. We were also concerned that, as these customers were profitable, firms do not have sufficient incentives to help customers repay more quickly.

2.7 We are proposing a set of interventions designed to help people who are in persistent credit card debt and which takes into account the diverse range of circumstances of customers in this position. This chapter sets out in detail how we propose to define persistent debt and the requirements we propose to place on firms to tackle it.

2.8 Draft Handbook text, new provisions for the Consumer Credit Sourcebook (CONC), can be found in Appendix 1.

Definition of persistent debt

2.9 The drivers of persistent debt are low repayments which result in an interest-bearing balance being sustained over a long period. We are proposing to define persistent debt as the circumstance where, over a period of 18 months a customer pays more in interest and charges than they have repaid of the principal.

2.10 For example, if on average over an 18 month period, a customer incurs interest and charges each month of £5 and repays £9, the ratio would be 1.25 as they have paid less (£4) of the principal than they have paid in interest and charges (£90 in interest and charges and £72 in principal over the 18 month period). Our definition captures accounts where this ratio is above 1 in any 18 month period. A high ratio indicates that repayment of principal is slow and high costs are being incurred.

2.11 Analysis of the CCMS dataset shows that there are around 4 million accounts in persistent debt at any given time. Each month between 220,000 and 250,000 accounts move into persistent debt each month and a similar number leave the definition. We also looked at how many accounts identified as being in persistent debt in 2013 were still in persistent debt 18 months later to see whether they typically move out of the definition over that period. We found that more than half of accounts in persistent debt in 2013 remained in the definition after a further 18 months. Based on 2013 and 2014 data, at any given time there are around 2.2 million accounts which have been in persistent debt for two consecutive periods of 18 months.

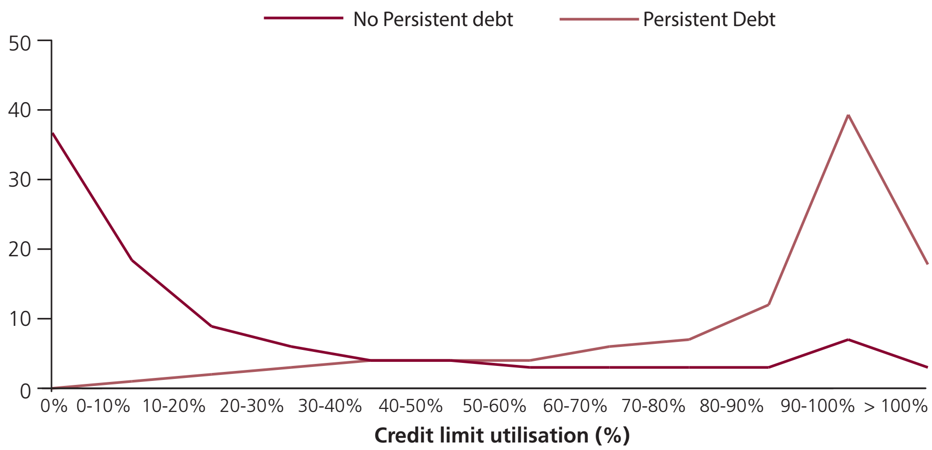
2.12 Accounts in persistent debt under our proposed definition are typically repaying approximately £2.50 in interest and charges for every pound of their balance they repay. Given the high costs of borrowing in this way over 36 months, it is likely that customers intentionally repaying slowly, but who can afford to start repaying more quickly, account for much of the decline between

18 and 36 months. This leaves customers who primarily cannot afford to repay more quickly or could repay more quickly but do not fully appreciate the costs of their repayment behaviour.

2.13 Analysis of the credit card market study dataset also shows that the customers in our proposed definition of persistent debt are more likely to have experienced objective measures of financial distress than the average credit card customer. For example, they are more likely to have been subject to a CCJ. They are also more likely to have taken out HCSTC.

2.14 Accounts in persistent debt have, on average, both higher balances and higher levels of credit limit utilisation than accounts that are not in persistent debt. On average, in our dataset, an account which is in persistent debt has a balance of £3,464 and a credit limit utilisation of 82%. By contrast, an account which is not in persistent debt has, on average, a balance of £1,259 and a credit limit utilisation of 7%.

Figure 1: Credit limit utilisation by debt state[9]



2.15 We considered different ways to define customers in persistent debt, including their credit limit utilisation and the cost of interest and charges they have paid relative to the amount they have borrowed. We also considered using the definition of 'persistent debt' referred to in the final report[10]. However, a customer may have persistent debt that represents only a small proportion of their overall credit limit and still be unable to afford to repay it any faster than at the contractual minimum. Including credit limit utilisation could exclude these customers from the definition and our intervention. Similarly, depending on the interest rate, a customer may be in persistent debt on a credit card for a long period before they reach a given cost threshold required to trigger an intervention.

2.16 By comparing payment of interest and charges to repayment of principal our proposed definition effectively takes into account factors such as the interest rate, cost of borrowing and the contractual minimum repayment on that particular account.

2.17 We are conscious that our definition will exclude some customers who are not repaying their debt quickly as a result of a repayment pattern that sees them make significant repayments each month but draw down a similar amount in new spending. We are less concerned about

9 Accounts in persistent debt at 18 months are depicted in this figure. The distribution is almost identical to the accounts that are still in persistent debt at 36 months.

10 In the final report we defined persistent debt as being where a customer has an average credit limit utilisation of 90% or above over a calendar year. We explain in detail why we do not feel this is the appropriate definition for our proposed intervention in the CBA in Annex 2.

these customers because if they were to reduce their new spending on their cards they would likely pay off the balance in two to three years, rather than the ten or more years it would take if making minimum repayments. We do not view this pattern as necessarily indicative of a long term problem. We therefore do not propose to address these customers as part of this intervention, but may investigate the issue further in future if evidence suggests this is warranted.

2.18 We consider 18 months is an appropriate period over which to assess whether a customer is in persistent debt. By extending longer than a calendar year this takes into account seasonal variations in spending and income – for example, summer work or spending on Christmas presents but also extends for a sufficiently long period for persistent patterns of repayment to emerge. By proposing to use a period longer than 12 months, there will be times where the previous 18 months may include two summers or two Christmas periods for example, which for some customers may skew the ratio of repayments to payment of interest and charges. We have weighed this against the desire to assess patterns of repayment across a long enough period to establish persistence and the fact that in any given month a significant number of accounts will move out of the definition of persistent debt. Intervening earlier would mean capturing customers who would have been expected to have moved out of the definition in the following months. In addition, the more intrusive part of the proposed intervention occurs after two consecutive periods of 18 months, at which point the risk of a skew in the ratio as a result of where the period falls across calendar years is much lower.

2.19 We propose to exclude accounts where the balance falls below £200 at any point during the 18 month period. This is to ensure we do not capture customers who have paid off all or almost all of their balance at some point in the 18 month period. There are also administrative costs of intervening with customers in persistent debt. For those with low balances the benefits of intervention are likely to be more than offset by those costs. In addition, firms' minimum repayment terms typically include the provision that a minimum repayment cannot be less than at least £5 (unless the debt is less than £5). Once the £5 minimum is hit, typically at a balance of £200, the ratio of the repayment of interest and principal reduces quickly.

Q1: Do you agree with our proposed definition of persistent debt?

Intervening when customers are in persistent debt

2.20 Given the variety of reasons that a customer may be in persistent debt, we propose a high level obligation on firms to help customers in persistent debt for three years repay their balance more quickly, and a stepped approach to the interventions required of firms. The first set of interventions, after 18 months, would be intended as a prompt to consumers to change their repayment behaviour if they can afford to do so. After 27 or 28 months, customers whose repayment pattern suggested they were on track to be in persistent debt for a second consecutive period of 18 months would receive a reminder as an additional prompt. A second set of interventions would place requirements on firms in relation to customers who are still in persistent debt after a further consecutive 18 month period (so have repaid more in in interest and charges than principal over two consecutive 18 month periods) and require firms to help them repay their balance more quickly.

2.21 We consider that there are likely to be two groups of customers in persistent debt after 36 months: those who could afford to repay more quickly and those who are unlikely to be able to do so. To estimate the size of each group under our intervention, we have first estimated how many additional accounts are likely to move out of persistent debt between 18 months and 36 months as a result of our intervention. Based on those accounts where customers could exit the definition by making only a small increase in repayments, and informed by data on customer response rates obtained as part of our firm survey, we have estimated that around 11% of the accounts that would otherwise be expected to be in persistent debt for 36 months would no longer be caught by the definition, reducing the expected number of accounts in persistent debt at that point to around 2 million.

2.22 Using whether or not an account has more than one missed repayment in the previous 18 months as a proxy for ability to repay more quickly, we have divided the estimated remaining 2 million accounts into those who may be able to repay more quickly and those who may not. We estimate that accounts held by customers who may be able to repay more quickly make up around 1.4 million of the accounts who would remain in persistent debt after 36 months, and hold outstanding balances of £5.2 billion.

2.23 In December 2014 the average balance of the group who we estimate could afford to repay more quickly was £3,824, on which the average contractual repayment was just under £102. A repayment schedule that would pay off such a balance within three years would require a fixed monthly repayment of £154. Such a repayment schedule would substantially cut the interest the account holder would pay over the lifetime of the balance. The second group of customers, who would be likely to receive forbearance under our proposals, represent an estimated 571,000 accounts with total outstanding balances of £1.85 billion. Illustrative examples of how customers in different groups could be affected as a result of the proposed intervention can be found from paragraph 2.52.

2.24 Affected customers will benefit from lower interest repayments over time as a result of faster repayment, which we estimate will peak at between £310 million and £1.3 billion per year, depending on how consumers and firms react to the proposed intervention. Over a number of years the total cost savings are expected to be within the range of £3 billion and £13 billion. The breadth of this range reflects the uncertainty about how customers will behave. For example, the more customers react by increasing their level of repayment but offset this with increased borrowing on their cards, the lower the savings through reduced interest repayments will be.

2.25 Further detail of this analysis can be found in the CBA in Annex 2.

The intervention at 18 months

2.26 Firms would be required on a rolling basis to look at each customer's repayment pattern over the previous 18 months and assess whether they have paid more in interest and charges than they have repaid in principal over that period. We are proposing that the rules would come into force three months after they are made, so firms would at that point be required to consider the previous 18 months. Firms would be required on an ongoing basis to repeat the assessment for each customer in each subsequent month, considering customers' repayment pattern over the 18 months prior to the date on which the assessment is being carried out.

2.27 Where a customer is identified as having repaid more in interest and charges than principal over the previous 18 months, we propose to require firms to contact them to set out that their pattern of repayment means they have repaid more in fees and charges than principal over the past 18 months and make clear the benefits of repaying more quickly. They would be warned that if they continue repaying less in principal than in fees and charges their card may be suspended in a further 18 months, which may be reported to CRAs. Firms would be required to provide the customer with the contact details of sources of not-for-profit debt advice and to encourage the customer to contact the firm to discuss their circumstances.

2.28 The intervention at 18 months is intended to encourage customers to consider whether they can afford to repay more quickly and, if so, to begin doing so to reduce their borrowing costs and repay their debt faster. It is also intended to encourage customers who cannot afford to repay more quickly to seek debt advice and discuss their circumstances with their credit card firm, and to warn those that cannot or do not of the steps that may come.

2.29 If, in the intervening period between 18 and 36 months, firms believe a customer's behaviour is likely to see them meet the definition of persistent debt at 36 months, we propose that they would be obliged to remind the customer in good time about the risks to them and actions required in order to avoid the 36 month intervention. We propose that this reminder would be required between 9 and 10 months after the 18 month intervention (i.e. 27 or 28 months after the first period of persistent debt began), but it would be open to firms to issue additional reminders at other times. The intention of this step is to provide an additional prompt to customers who seem likely to be in persistent debt for a second consecutive 18 month period to consider whether they can repay more quickly and, if not, to take steps to seek debt advice. It is also to provide a further reminder to customers who cannot or do not make faster repayments of the steps that may follow.

2.30 The persistent debt definition requires firms to look back over a customer's repayments over the previous 18 months. This means that as each month passes, firms will be assessing the customer's repayments over a slightly different period of time. As a result, customers could continue to meet the definition each successive month which would lead to the unhelpful outcome of receiving the 18 month intervention repeatedly. To avoid this scenario, we have specified in the draft instrument that firms do not need to carry out the 18 month intervention with customers who have received that intervention within the previous 18 months. Similarly, where a customer is subject to the 36 month intervention, and over the previous 18 months at that point they have repaid more in fees and charges than principal, it would not make sense for them to receive the 18 month intervention again.

Q2: Do you agree with our proposal for intervention at 18 and 27 months?

The intervention at 36 months

2.31 Firms would be required to assess again at 36 months whether the customer has remained in persistent debt for a second consecutive period of 18 months. Where this is the case, firms would be required to help customers repay their outstanding balance more quickly. To do this, firms would have to contact affected customers and offer them a way, or choice of ways, to repay more quickly in a reasonable period. We expect that a reasonable period would be three to four years. We believe this period is appropriate because these customers have already been repaying their balances slowly over at least three years and it is similar to the typical length of a personal loan for a similar amount to the typical balances of customers in persistent debt. Customers would also be told that if they do not respond to tell the firm either that they accept the proposed faster repayment or that they cannot afford any of the options, their card would be suspended. Customers would also be directed to sources of not-for-profit debt advice.

2.32 We expect that firms would be able to provide their customers with a range of possible mechanisms to repay more quickly, for example by putting in place a fixed sum personal loan, or offer options for increasing the monthly repayments in such a way as to repay their balance sustainably in one, two, three or four years, depending on what the customer confirms they can afford. We would expect that firms would put in place an appropriate vehicle following engagement with the customer[11].

2.33 Our proposals do not require firms to suspend or cancel the card of a customer who has accepted a repayment option proposed by the firm. This is intended to provide customers with an incentive to accept a repayment proposal, and to provide firms with an incentive to engage effectively. We expect that firms and customers will generally wish to avoid suspension of the credit card and in particular that customers would want to avoid a report to a CRA of this fact.

2.34 However, firms would be required to take reasonable steps to ensure that customers do not get into persistent debt in relation to new balances. We do not intend to prescribe how firms would have to achieve this but, for example, it could include the customer agreeing to repay – in addition to the amount agreed for the outstanding balance at 36 months – an amount equivalent to twice the interest and charges due on any new spending, or firms could propose a level of repayment sufficient to ensure the customer was repaying enough principal to avoid the definition of persistent debt in relation to new spending.

2.35 The purpose of this requirement is to avoid the situation where a customer who is subject to the persistent debt intervention at 36 months is repaying that balance but developing persistent debt on new balances at the same time. For example, if a customer has agreed a repayment plan that sees them repay £150 each month but they subsequently start spending £100 per month on the card without making any additional repayments this would lead to a situation where the customer would, after 18 months, meet the definition of persistent debt in relation to the new spending. This would fundamentally undermine the effectiveness of the intervention as a means of helping customers out of persistent debt.

Q3: Do you agree with our proposals for intervention after 36 months of persistent debt for those customers that can afford to repay more quickly?

Q4: Do you agree that three to four years is a reasonable period over which firms must help customers repay the balance?

When a customer cannot sustainably repay more quickly

2.36 Where a customer confirms they cannot afford any of the options proposed by the firm to repay the balance more quickly, we propose to require firms to treat the customer with forbearance and due consideration. The nature of forbearance is not prescribed, but it should have the aim of assisting the customer to repay the balance in a reasonable period, and may include reducing, waiving or cancelling any interest or charges to the extent necessary for the customer to be able to repay their balance in a reasonable period. Firms would also be required to treat customers who agree a repayment plan but fail to make the agreed repayments (so that it is unlikely the debt will be repaid in a reasonable period) with forbearance and due consideration.

2.37 We are proposing to require forbearance for customers who cannot afford to repay more quickly because without it customers would not be able to repay the debt in a reasonable period. These customers otherwise would likely remain in persistent debt, making very slow progress in repaying their debt and incurring significant debt service costs. This may be disguising underlying financial difficulty. In contrast, customers who pay below the minimum payment and fall into arrears are generally treated appropriately and affordable repayment plans put

11 For firms able to offer a fixed sum instalment plan under their credit card agreements, this may be a way for customers to repay more quickly.

in place, often with interest rate concessions. We expect that in many cases the difference in circumstances between customers who can just about afford the minimum repayment and customers who cannot quite afford it is not likely to be significant.

2.38 We would expect that firms would normally suspend use of the customer's card where forbearance is being exercised, unless there are exceptional circumstances, for example, if a customer expects a windfall payment in the near future, or is due to start higher paid employment.

> **Q5: Do you agree with our proposal for a requirement to exercise forbearance and due consideration for customers in persistent debt who cannot sustainably repay more quickly?**

Suspending further use of the credit card

2.39 This section describes our proposals regarding the potential cancellation or suspension of the card of a customer in persistent debt, and the rationale for our approach.

2.40 At the 36 month stage, our proposal is that a firm must cancel or suspend the card of a customer in persistent debt if they do not respond to the repayment options proposed by the firm to say either that none of the options are affordable, or one or more of the options is affordable and the customer agrees to make those payments. The rationale for requiring firms to cancel or suspend in all other cases is to provide a strong incentive for customers to engage with the firm's proposed ways of repaying in a reasonable period, and to incentivise firms to ensure they engage effectively with customers. We expect that both parties will strongly prefer to maintain use of the card, and customers are also likely to want to avoid the risk of a report being made to CRAs.

2.41 Where the firm is required to treat a customer with forbearance (either because the customer has stated that they cannot afford the repayment options, or has not made repayments in accordance with an agreed repayment plan so that it is unlikely the customer will repay the debt in a reasonable period) we expect firms to cancel or suspend the card, in order to ensure that the customer repays the balance in a reasonable period. This expectation does not apply where suspension or cancellation would have a significant adverse impact on the customer's financial situation. In these circumstances firms will need to consider whether there are circumstances to justify allowing the customer to continue to spend on the card. This is intended to reduce the risk that customers subject to our proposed interventions would end up in a worse situation as a result, and strikes a balance between the potentially urgent need of the customer to use the card and the benefits of no longer being in persistent debt.

2.42 We have considered the risk that some customers who have their ability to use their card suspended may turn to higher cost forms of credit, such as HCSTC credit or guarantor loans, or may go into overdraft on their bank account. It is possible that some customers may do this but it will be influenced by factors such as the reason a given customer is in persistent debt in the first place, whether they are worried about the size of their debt, what they have been using the credit card for, the nature of previous contact from their credit card firm and whether they have access to other credit (e.g. other credit cards with available credit, or overdrafts). Separately, we are planning to undertake further work in relation to high-cost credit generally, as discussed in our recent call for input[12]. If in due course that work identifies consumer detriment in those markets, this is likely to lead to proposals for intervention that would help address any such issues identified.

12 https://www.fca.org.uk/publications/calls-input/high-cost-short-term-credit-price-cap

2.43 The remedy is designed to mitigate this risk, in as much as firms would only be required to cancel or suspend use of the card where a customer does not engage at the 36 month stage or confirms they can afford increased repayments but declines to make them. Although we would expect firms to cancel or suspend use of the card where a customer is being shown forbearance, it is nonetheless open to firms to decide to allow the customer to continue to use the card in exceptional circumstances.

2.44 Some customers who are unable to afford to repay more quickly, and as such receive forbearance and have their use of the card suspended or cancelled, may be able to access high cost credit but given that customers in this scenario will have very little additional disposable income it is likely that they would not meet the creditworthiness assessment under our rules or the lending thresholds of many firms. In addition, it is likely that suspending the customer's use of the card would be reported to CRAs, in which case other lenders would likely be aware of the customer's circumstances, which may make them less likely to lend.

2.45 Where a customer agrees to a repayment plan and adheres to it, it will be a matter for firms as to whether the customer's card is cancelled or suspended[13]. Our proposal does not require or expect firms to do so.

2.46 Customers who are able to afford to repay more quickly are only likely to have their use of the card suspended if they do not engage with their firm or do not agree to repay more quickly. These customers will tend to have access to other credit cards in relation to which they may not be in persistent debt, or in any case be sufficiently creditworthy to access a variety of other forms of credit. We estimate that 42% of consumers meeting the persistent debt definition had more than £1,000 available credit on other cards, while 15% had more than £7,000 available card credit. It seems relatively unlikely that the persistent debt intervention would push them towards use of credit in a way that would be likely to worsen their circumstances.

2.47 It is nonetheless a risk for a small number of customers, for many of whom the most beneficial course of action would be to seek debt advice. To this end, all customers will be made aware of the availability of not-for-profit debt advice at each stage of the intervention.

Q6: Do you agree with our proposals regarding suspending use of the credit card?

Customers who do not engage at 36 months

2.48 Customers who do not engage with their firm at 36 months would automatically have their ability to use the card suspended. This suspension would continue until the customer has engaged and agreed a proposed repayment schedule or repaid the balance.

2.49 We do not propose any specific requirements on firms in relation to the outstanding balances of customers in these circumstances, on the basis that we have to strike a balance between intervention and consumers' responsibility for their own actions. We do not consider that it would necessarily be inappropriate for a firm to allow such customers to continue repaying at their current level. However, it would be open to firms to decide they wanted to treat these customers differently where doing so would be compliant with firms' wider regulatory obligations including Treating Customers Fairly and be legally fair. For example, a firm may be

13 Section 98A of the Consumer Credit Act states that the right to draw on credit must only be suspended for reasons that are objectively justified.

able to objectively justify terminating the credit agreement and calling in the debt or, at the other end of the spectrum, may offer forbearance if doing so was appropriate. It is also possible that a firm may also identify some such customers under the proposed earlier intervention rules discussed in Chapter 3.

Q7: Do you agree with our proposals for customers who do not engage at 36 months?

Variation of contractual terms

2.50 We recognise that some firms may have to use a unilateral power of variation in order to introduce terms necessary to allow them to suspend or cancel a customer use of their card, offer forbearance or put in place a repayment plan as part of the persistent debt intervention. It is possible that some firms may not have an appropriate unilateral power of variation that would allow them to introduce such a term and would have to issue a modifying agreement. We would welcome feedback on this issue.

Q8: Do you have any views on the potential need for novation of existing contracts or modifying agreements in order to suspend or cancel customers' use of their card, provide forbearance or put in place a repayment plan?

Reviewing progress with new repayment arrangements

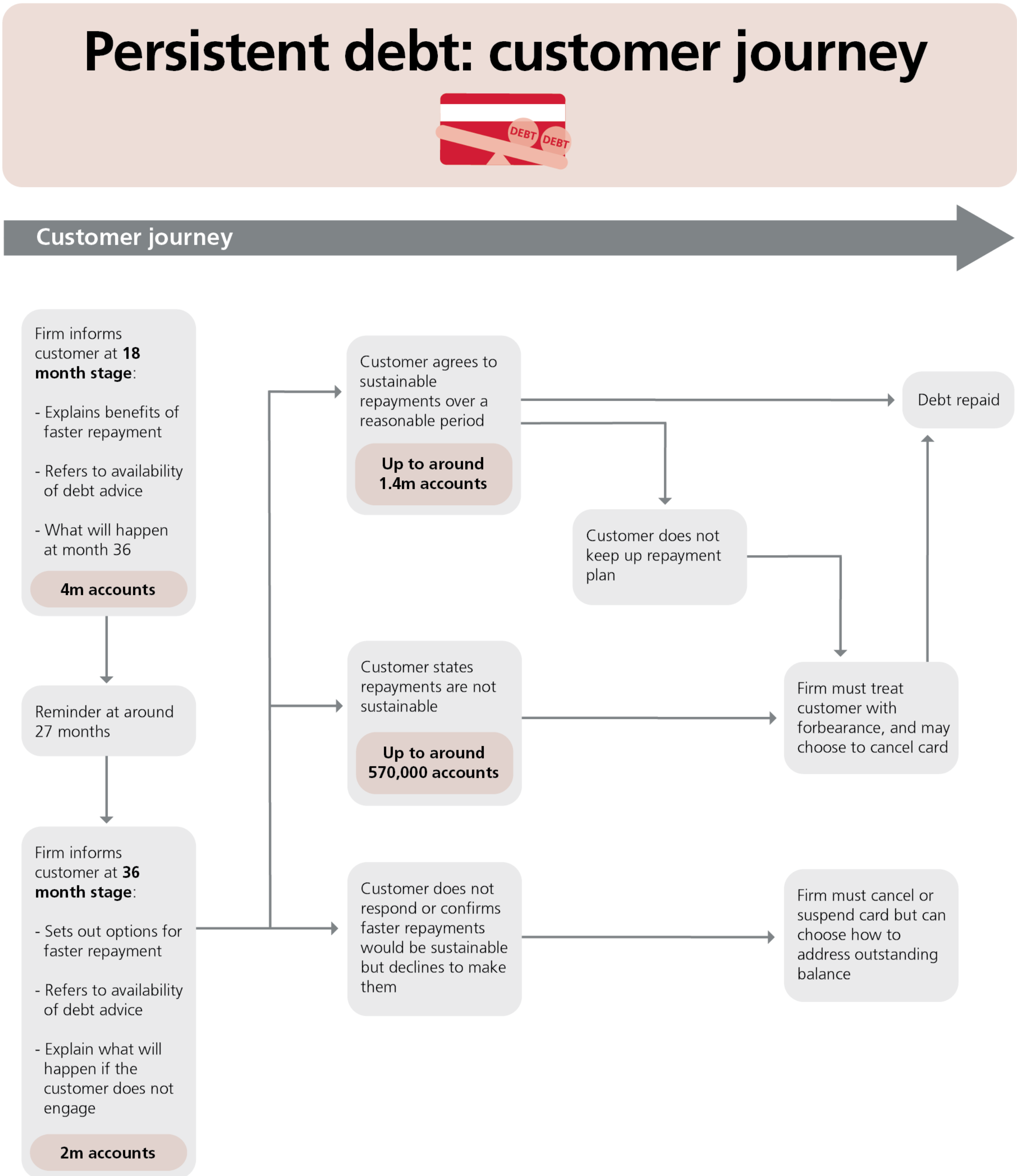
2.51 We recognise that not all customers will adhere to the schedule of repayments they have agreed to, possibly because their circumstances have worsened or the original schedule was not affordable. Where a customer has entered into new repayment arrangements with firms as a means of repaying more quickly, we propose to require firms to intervene if the customer misses repayments in a pattern that suggests it is unlikely they will repay the debt in a reasonable period. In these circumstances we require firms to treat the customer with forbearance and due consideration as there are clear indications that they cannot afford the agreed repayments.

Q9: Do you agree with our proposal that the firm must treat a customer with forbearance where the customer is unlikely to repay the balance in a reasonable period under a repayment arrangement?

Illustrative examples of the persistent debt intervention

2.52 To help explain how our proposed rules on persistent debt would work, we have set out some examples of how a customer in persistent debt would be treated differently under our proposals.

2.53 The flowchart below offers an overview of how the intervention works at a high level.

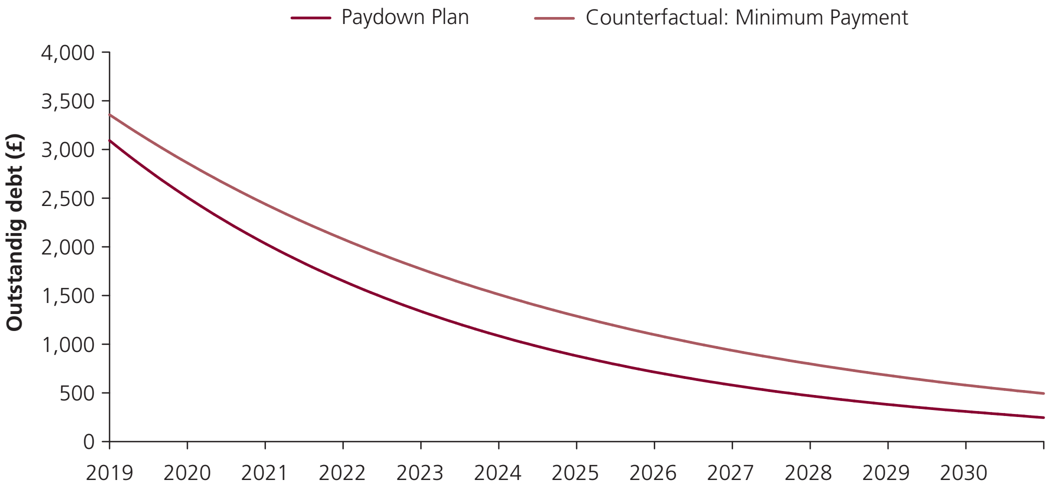


2.54 To illustrate how the impacts on customers are being estimated, Figure 2, 3 and 4 below show the amortisation of the outstanding balance in the case of the upper-bound scenario for the three types of customer in persistent debt. They illustrate how the average[14] outstanding balances are reduced over time as a result of the customer being subject to the proposed

14 These impacts are calculated as a weighted average of the repayment schedule for the high and low balance accountholders.

intervention. This repayment schedule is compared with a counterfactual level of repayment.[15] Interest savings are estimated up to 2030.

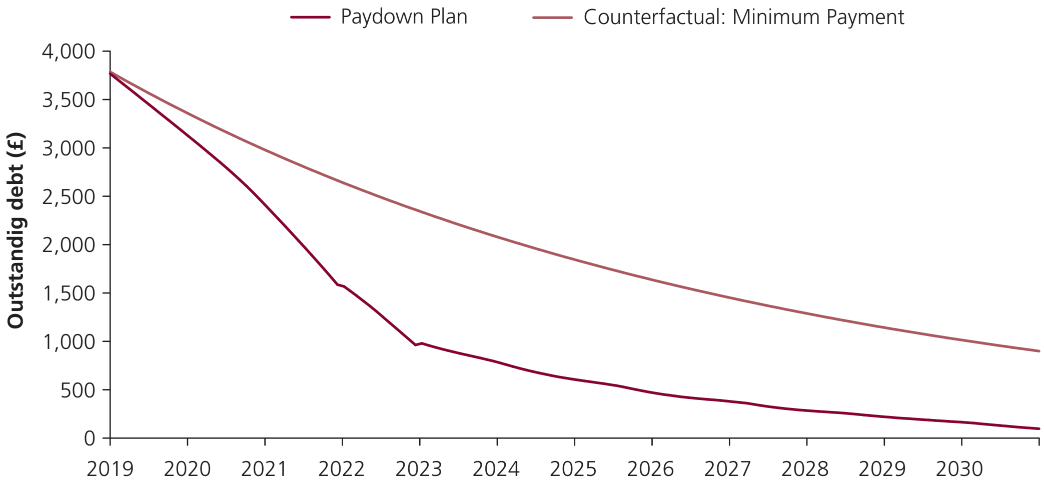
Figure 2: Accounts that exit persistent debt between 18 and 36 months
Initial Balance: £3,403 | Interest Savings*: £993



* Interest savings estimated out to 2030

2.55 In the case of average customer who exits persistent debt between 18 and 36 months the main benefit arises from the increases in repayments prior to 36 months. As a result of this faster repayment, these accounts will have a lower initial balance at the 36 month intervention point, which is the point at which the chart above begins, resulting in future cost savings. We estimate the average interest savings for these customers is £993.

Figure 3: Accounts who agree a faster repayment schedule
Initial Balance: £3,824 | Interest Savings*: £2,768



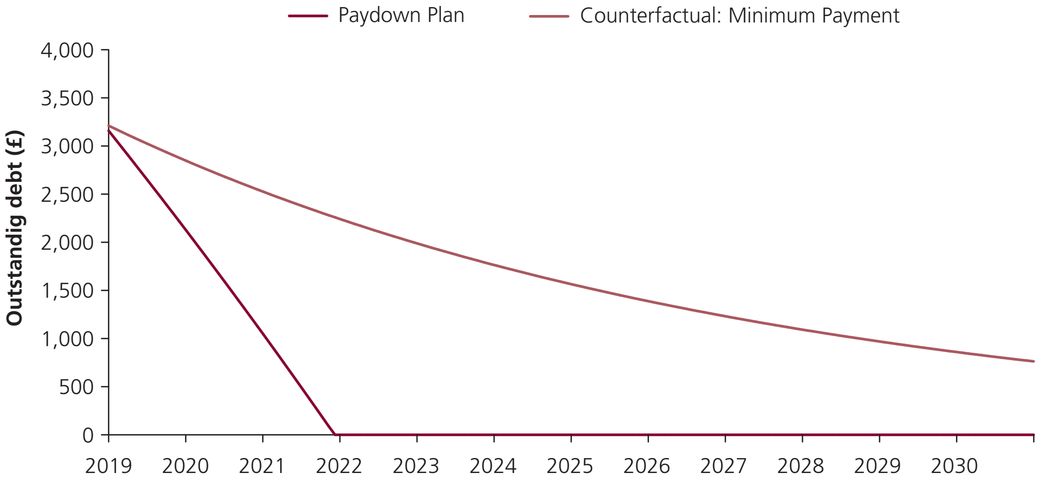
* Interest savings estimated out to 2030

15 See paragraph 171 for description of the assumptions used in constructing the repayment schedule for both the pay-down plan and minimum payment counterfactual for each accountholder type.

2.56 The impact on a customer who accepts a proposed repayment schedule is shown in Figure 3. These customers agree to a repayment schedule which would pay down the original debt in 3 years (4 years where original debt is £5,000 or more), but because they continue spending on their card they will have a residual balance to pay down beyond 2023. We estimate the average interest savings for these accountholders is £2,768.

Figure 4: Accounts receiving forbearance

Initial Balance: £3,243 | Interest Savings*: £4,691



* Interest savings estimated out to 2030

2.57 Finally, customers who they cannot afford to repay their outstanding balance in a reasonable period are, in this scenario, offered a repayment schedule which will pay down the original debt in 3 years but are given interest forbearance. We assume that further borrowing is suspended while the account is on such a repayment schedule. This repayment schedule is shown in Figure 4. We estimate the average interest savings for these accountholders is £4,691.

Commencement of the proposed rules

2.58 Because we are intending that this remedy will deliver help to customers who may already be in persistent debt, we want to minimise the period of time before the first stage of the intervention would be triggered. If the first 18 month interventions did not occur until 18 months after the rules were made it would have the effect of potentially making people who are currently in persistent debt wait a significant period of time before being offered assistance.

2.59 In that light, we propose that firms will have to comply with the rules three months after they come into force. This means that on this date firms would have to assess which customers have been in persistent debt for the previous 18 months. This period would include the 15 months before the rules came into force.

2.60 This would allow firms a period of three months from the date of the rules being made to make any necessary systems changes and prepare to identify and contact customers falling within by the definition of persistent debt.

Q10: Do you agree with our proposals for commencement of the Handbook provisions?

Interaction with the earlier intervention proposal and existing forbearance rules

2.61 The proposed persistent debt and earlier intervention remedy discussed in Chapter 3 are designed to work together and are complementary. In addition, the persistent debt remedy is also designed to work together with existing rules on forbearance in CONC 7.3.4R. The starting point is that we propose guidance to remind firms that the application of rules on persistent debt does not reduce or remove the obligation on a firm to take appropriate action where there are signs of actual or possible financial difficulties under our proposed earlier intervention rules or to treat customers in default or arrears difficulties with forbearance and due consideration under CONC 7.3.4R, and vice versa. So, for example, if a customer had been in persistent debt for 30 months, and at that point either was in default or arrears difficulties, or demonstrated signs of actual or possible financial difficulties, firms would be required to take action under CONC 7.3.4R or our earlier intervention rules. It may be that the customer, following the intervention, would not be in persistent debt at the 36 month stage, and so the persistent debt rules would not apply. If, notwithstanding the steps taken by the firm at month 30, the customer was still in persistent debt at month 36, generally the persistent debt rules will still apply.

2.62 However, we have considered some specific scenarios where we do not propose firms will be required to comply with certain aspects of the persistent debt rules. We propose that the communication requirements at 18, 27 and 36 months under the persistent debt intervention would not apply where a customer's account is already subject to equivalent or more favourable treatment. In these circumstances we consider the communications may be confusing for the customer and are not necessary given the steps already being taken by the firm.

2.63 There are a wide number of ways that a customer could be subject to the forbearance requirement under CONC 7.3.4R, earlier intervention and persistent debt remedies in practice. For example, where the spending and repayment pattern of a customer in persistent debt changes in such a way that suggests they are at risk of financial difficulties, a firm would be required to comply with the earlier intervention rules in addition to those relating to persistent debt. This is because the customer's circumstances may have worsened since the 18 month intervention and it would be appropriate for the firm to take action at this point rather than waiting for the customer to fall into arrears or reach the 36 month point triggering requirements under our propose persistent debt rules.

2.64 Similarly, a firm which possesses CRA data that provides insight into a customer's wider financial circumstances may detect that the customer has fallen into arrears on other borrowing and decide to take appropriate steps in relation to this, for example referring the customer to debt advice. If the customer is able to continue making repayments on their credit card but subsequently meets the definition of persistent debt, the firm would be required to comply with those rules regardless of having previously taken appropriate steps under the earlier intervention rules.

2.65 It is also possible that customers subject to the persistent debt intervention at 36 months may agree a sustainable repayment plan but subsequently have a change in their circumstances that means they are repaying in such a way that they are unlikely to repay the debt in time. Under the persistent debt rules the firm would be required to show the customer forbearance and due consideration, but they would also potentially be subject to appropriate steps under the earlier intervention rules if the firm had identified them as being as risk of actual or potential financial difficulties. The fact that a customer is subject to the persistent debt intervention should not stop firms considering whether additional measures such as earlier intervention would be appropriate in their specific circumstances.

2.66 A customer who is being shown forbearance under CONC 7.3.4R or earlier intervention may also fall into the definition of persistent debt and trigger the 18 month intervention. Where the customer is already being treated in an equivalent or more favourable way than would be the case under the persistent debt rule, the requirement to notify customers about the 18, 27 or 36 month intervention would not apply. Similarly, if a customer who has been subject to the 18 month intervention subsequently falls into arrears in the following months and is being treated under CONC 7.3.4R or earlier intervention equally or more favourably than they would be under the 27 or 36 month stage of the persistent debt intervention, those notifications would not apply.

Q11: Do you agree with our proposals regarding interaction between persistent debt, earlier intervention and CONC 7.3.4R?

Interaction with potential intervention on minimum repayments

2.67 As detailed in Chapter 5, we are currently carrying out trials as part of planned work to consider whether there is a case for intervening in relation to minimum repayments, either by 'nudging' customers to repay faster or requiring it.

2.68 Depending on how such a change was implemented, were we to propose to do so, it is possible that it would have an effect on the number of customers who get into persistent debt and it could present an alternative way of tackling the issue. However, we take the view that it would be inappropriate to wait to complete that work before proposing intervention in relation to persistent debt. There are a number of reasons for this.

2.69 As our evidence gathering and analytical work is still underway, it is not possible to say with any certainty at this point that we will subsequently propose any changes to the rule on minimum repayments.

2.70 Any change we might propose in relation to minimum repayments could be insufficient to prevent customers getting into persistent debt, undermining its use as an intervention to address that issue.

2.71 If we were to propose a change to the minimum repayments rule, depending on a range of factors, it is possible that it may not be proportionate to apply it to existing credit card accounts which would in turn undermine its effectiveness as a means of tackling persistent debt.

2.72 The likely timetable for implementing any proposals in relation to minimum repayments means that intervention is not due in the near future. We have already identified that persistent debt is an issue we have significant concerns about and delaying our proposed intervention to consult alongside other potential proposals on minimum repayments in due course could undermine our consumer protection objective

3. Earlier intervention

In this chapter, we propose new rules and guidance to require credit card firms to identify earlier those customers who may be struggling to repay and take appropriate action.

Introduction

3.1 In the CCMS interim report[16], we suggested that credit card firms could do more to identify customers at risk of financial difficulties sooner and take action before repayments are missed.

3.2 Our current rules require firms to monitor a customer's repayment record for signs that they may be struggling to repay (CONC 6.7.2R) and take action where there are signs of actual or potential financial difficulties.

3.3 Our current guidance (CONC 6.7.3G) explains that such action should generally include notifying the customer of the risks of escalating debt, additional interest or charges, and of potential financial difficulties and providing contact details for not-for-profit debt advice bodies.

3.4 We do not consider that these rules and guidance go far enough to address potential harm to credit card customers that are at risk of financial difficulties. As credit cards are open-end running accounts with no fixed or maximum duration, they are different to fixed-sum loans, with greater risks for both the customer and firm, including potentially of higher-cost longer-term lending. We are therefore proposing to strengthen them.

3.5 In addition, credit card firms have access to wider data than simply repayment records. This includes access to account usage data and may also include CRA data and data about other products held with the same firm or group, such as overdrafts and personal loans. These data sources can provide indicators to credit card firms that customers are in actual or potential financial difficulties. We consider that firms should have regard to data the firm holds (including repayment data but also other data) to identify customers at risk. To be clear, this is not a requirement on firms to gather new information, but to monitor the information they already hold. We discuss in the CBA our assessment of firms' ability and incentives to do this.

3.6 Respondents to the interim report were generally positive to earlier intervention to support customers who were showing signs of financial difficulties. Some firms stated that they had already taken steps in this area and were committed to enhancing these efforts.

3.7 Other firms highlighted that there was a challenge in getting customers to engage with them before they missed repayments. Customers who are in actual or potential financial difficulties

16 www.fca.org.uk/publication/market-studies/ms14-6-2-ccms-interim-report.pdf.

may be unwilling to acknowledge their position and be reluctant to engage with firms to discuss their financial situation.

3.8 Some firms suggested that contact needed to be handled sympathetically and different methods of contact trialled in order to ensure that it was effective.

3.9 Our proposals seek to address the issues set out above.

Proposed rules

3.10 We are proposing new high-level requirements in CONC to require earlier intervention in relation to credit cards. These will not affect the current requirements in CONC 6.7.2R with respect to all other forms of consumer credit lending.

3.11 The draft rules set out in Appendix 1 will require firms to monitor a customer's repayment record and any other relevant information that it holds and take appropriate action where there are signs of actual or possible financial difficulties. Firms are also required to establish a policy in relation to earlier intervention and to implement it.

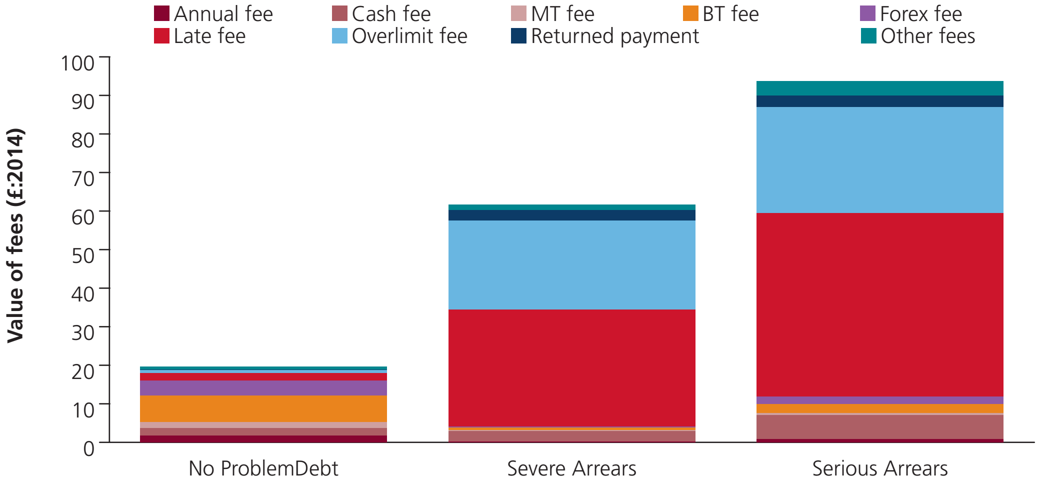
We propose that the rules will consist of three elements:

- credit card firms will be required to monitor a customer's repayment record and any other relevant information that the firm holds to identify signs of actual or possible financial difficulties
- firms must take appropriate action where there are such signs, and
- firms must establish, implement and maintain an adequate policy for identifying and dealing with customers showing signs of actual or possible financial difficulties, even though they may not have missed a payment

3.12 The rationale for the proposed requirement to establish and implement adequate policies for dealing with customers at risk of arrears is to promote a consistent approach within a given firm, but also to enable the FCA to supervise effectively.

3.13 One of the benefits to customers from this intervention will be in the form of savings made by avoiding charges or interest associated with being in financial difficulty. The chart below compares average annual fees for accounts that are not in problem debt with those that are in arrears. It is clear from the chart that accounts in arrears pay four to almost five times more per year than accounts that are not in problem debt. The chart also shows that a significant proportion of these fees comes from late and over-limit fees.

Figure 5: Estimate of the average fees by account[17]



Source: FCA analysis of account-level submissions

Monitoring

3.14 Our current rules require firms to monitor a customer's repayment records and take appropriate action where there are signs of actual or possible financial difficulties. This is an adequate approach for many lending products since the repayment record is the most appropriate data to monitor for signs of difficulty. Our view is that, for credit cards, the ability to comply with contractual requirements by making minimum payments may mask financial difficulties.

3.15 We are aware from our survey of firms that there are other sources of information that may be available to firms. Firms have advised us that monitoring account usage data (sometimes referred to as 'drawdown behaviour'), CRA data and, where available, data from other credit products held with the same firm can provide early indicators of potential difficulties and many firms do this already. We set out our thinking on these data sources in brief below.

Drawdowns

3.16 All firms have access to drawdown data. These may include data on accounts where the credit limit is exceeded, cash withdrawals and money transfers to current accounts.

3.17 It is important for firms to monitor these data for the purposes of identifying customers in actual or potential financial difficulty. We consider that it will fill a gap in the current rules because, although for fixed sum loans, the only variable is repayment, for running-accounts it also includes drawdown data. Either or both could facilitate early identification of financial difficulties.

3.18 We do not propose to consult in specifying in rules or guidance particular aspects of drawdown behaviour that should be monitored since firms will be best placed to identify the most appropriate indicators.

17 Account types, i.e. 'no problem debt', 'severe arrears' and 'serious arrears', are based on the problem debt definitions which the FCA used in the Credit Card Market Study.

CRA data and other product data

3.19 Some firms will utilise and have access to data from CRAs. For example, these may include data on the credit score of an individual and their level of indebtedness. Firms may also have access to data about other products that are held with the same firm or group such as overdrafts and personal loans.

3.20 CRA data and data about other product data will not necessarily be available to all firms. Accordingly, we propose that there be a general requirement on firms that they monitor other data that they may have available that may provide evidence of potential financial difficulties.

Q12: Do you agree with our proposal to require credit card firms to monitor other data in addition to a customer's repayment record?

Signs of actual or possible financial difficulties

3.21 For the purposes of the rule, signs of actual or possible financial difficulties include where there is a significant risk of one or more of the following matters (set out in CONC 1.3.1G) occurring:

- consecutively failing to meet minimum repayments in relation to a credit card or store card
- adverse accurate entries on a credit file, which are not in dispute
- outstanding CCJs for non-payment of debt
- inability to meet repayments out of disposable income or at all
- consecutively failing to meet repayments when due
- agreement to a debt management plan or other debt solution
- evidence of discussions with a firm (including a not-for-profit debt advice body) with a view to entering into a debt management plan or other debt solution or to seeking debt counselling

Q13: Do you agree firms should be required to take appropriate action where there are signs of actual or possible financial difficulties?

Q14: Do you agree that signs of actual or possible financial difficulties should include where there is a significant risk of one of the matters in CONC 1.3.1G occurring?

Appropriate action

3.22 We are proposing to give examples in guidance of steps that may constitute the appropriate action that a firm should take where it has identified that a customer is showing signs of actual or possible financial difficulties.

3.23 We propose that our current guidance on actions (for example CONC 6.7.3G) will be retained but further potential actions that a firm may consider be added to comprise an escalating set of actions applicable to credit cards. These additional actions go further than notifying the customer of the risks and signposting them to not-for-profit debt advice bodies. In particular, they would include the firm doing one or more of the following, as may be relevant in the circumstances:

- considering suspending, reducing, waiving or cancelling any further interest or charges
- accepting token payments for a reasonable period of time in order to allow a customer to recover from an unexpected income shock
- notifying the customer of the risk of escalating debt, additional interest or charges and of potential financial difficulties
- providing the contact details for not-for-profit debt advice bodies and encouraging the customer to contact one of them. This latter element goes further than the similar provision for non-credit cards

Q15: Do you agree with the proposed examples in guidance in CONC on what may constitute appropriate action where a customer is showing signs of actual or possible financial difficulties?

4.
Control over credit limit increases

In this chapter, we set out how our concerns about unsolicited credit limit increases will be addressed through voluntary industry remedies. All new customers will be offered a choice at the outset of the agreement as to whether their credit limit can only be increased with their express consent, or whether their firm can offer an increase to their limit with the option to decline it. Existing customers will be given an easy means of choosing whether to accept or reject an offer of a credit limit increase, or not to receive any offers at all. Existing customers may also choose whether to have to give express consent to future offers. The voluntary remedies also restrict customers from being offered credit limit increases where their borrowing behaviour may indicate unaffordable borrowing.

Introduction

4.1 As we set out in the CCMS final findings, we want to ensure that consumers – especially those at risk of debt problems – have proper control over their credit limits, to them avoid borrowing more than they intend to.

4.2 At the same time we recognise the commercial and risk management benefits to credit card companies of being able to offer a modest credit limit to a new customer with a limited credit history, for example, with the option to increase the limit if appropriate as they are better able to assess the customer's credit risk (the 'low and grow' model).

4.3 Currently, it is a common (though not universal) practice for credit card firms to offer UCLIs on an 'opt out' basis. In other words, the credit card firm can propose an increase in a customer's credit card limit without the customer having requested it and, if the customer does not decline the offer, the increase will be implemented without the customer having actively accepted it.

4.4 Our understanding of consumers' behavioural biases suggests that an 'opt out' system for UCLIs is likely to lead to some customers passively accepting the offer without considering whether they want or need the proposed increase. We are also concerned that some credit card customers in financial difficulties appear to be receiving UCLIs and that this could contribute to a worsening of their circumstances.

Evidence on credit limit increases

4.5 Analysis of the CCMS dataset offers some insight into how credit limit increases operate across the credit card market and their impact on customers who receive them.

4.6 The number of credit limit increases has grown in recent years. In 2014, 18% of all accounts received one, whereas the figure was just over 10% in 2010. Figure 6 illustrates this across different market segments.

Figure 6: Proportion of accounts receiving a credit limit increase (2010–2014)

Source: FCA analysis of account-level submissions

4.7 'Low and grow'[18] cards account for a significant proportion of credit limit increases. This is what we would expect to see given that the business model involves giving customers a relatively low initial credit limit and increasing it over time as customers demonstrate their ability to manage the card and firms are better able to judge the customer's creditworthiness.

4.8 Our analysis of 2014 data shows that receiving a credit limit increase is associated with an increase in spending, with accounts that received a credit limit increase having an average balance £458 higher at the end of the year. The average credit limit increase was £1,321.

4.9 It does not however show a link between credit limit increases and problem debt, even within the low and grow segment. This is likely to be because firms try to target credit limit increases to their more creditworthy customers.

Industry voluntary remedies

4.10 Since the publication of the final findings report, we have continued to engage with industry about our concerns relating to consumer control and the risk of detriment for customers in financial difficulties.

4.11 Prompted by the concerns identified in the report, in discussions facilitated by UKCA, we have reached an agreement. We believe this achieves our objectives in an effective and timely manner. We will, however, monitor its implementation and that it does in due course deliver the intended outcomes.

4.12 The agreement will operate in the context of existing obligations on firms in relation to credit limit increases. CONC 6.2.1(R)(1)(b) states that before significantly increasing a credit

18 For the purposes of this analysis we considered any account with an interest rate of 30% or above as a 'low and grow' account, and all others to be 'prime'.

limit for running-account credit, the lender must undertake an assessment of the customer's creditworthiness. The firm must consider the potential for the increase to adversely impact the customer's financial situation. CONC 6.7.7(R) also states that a firm must not increase, or offer to increase, the customer's credit limit where they are at risk of financial difficulties.

4.13 The industry voluntary package is made up of two parts, giving customers greater control over their credit limits and restricting offers of credit limit increases where there is a potential risk of financial detriment.

Giving customers greater control over their credit limits

- New customers will all be given the choice of how credit limit increases are applied to their account. They may choose either not to receive a credit limit increase unless they expressly accept it (opt in), or to have a credit limit increase applied on their account automatically unless they decline it (opt out). Customers who do not make a choice will be offered credit limit increases on an opt in basis by default.

- Existing customers will be offered a more straightforward means of declining an offer of a credit limit increase, as well as the choice of having any future offers made on an opt in basis.

- In addition, all customers will be made aware of their existing right to choose to no longer receive offers of credit limit increases.

- All customers will still be able to ask for a credit limit increase at any point.

4.14 The objective is to make it as clear as possible to customers that they have a choice as to how their credit limit is managed over time, and that they have the option to assume full control over this should they want to. Where customers are required to opt out, firms will make the mechanism as simple as possible.

4.15 We have also worked with industry to ensure that unsolicited offers of a credit limit increase are presented neutrally, rather than as a reward.

Credit limit increases where there is a greater risk of unaffordable borrowing

4.16 In addition to these changes, the industry will restrict offers of credit limit increases where behaviour may indicate that the customer is at risk of unaffordable borrowing such as habitual minimum repayments and high credit utilisation. These restrictions are in addition to existing commitments under the Standards of Lending Practice regarding customers in arrears[19].

4.17 Restrictions on credit limit increase offers will apply when borrowing or repayment patterns have continued for a period of time that suggests an increasing likelihood of unaffordable borrowing. In relation to habitual minimum repayment lasting eight months or more[20], firms will not be permitted to increase the limit of a customer without the customer's express agreement. After 13 to 14 months the firm will not offer any limit increases. These timeframes were selected by the industry on the basis that a firm wil have been able to assess any change in repayment behaviour following the initial and follow-up communications sent to customers making minimum repayments.

4.18 In addition, where customers have a high credit limit utilisation over an extended period firms will not be permitted to increase the limit of a customer without the customer's express

19 https://www.lendingstandardsboard.org.uk/the-slp/

20 For the purposes of this remedy, industry has defined this using a ratio which ensures that customers paying up to 10% more than the minimum (as an average) are also captured.

agreement. The detail of these metrics will be subject to further discussion in the light of the proposals in this CP.

4.19 Customers affected by either trigger will still be able to request a credit limit increase at any time, which the firm will consider in the usual way.

Table 1: Trigger points for restrictions on credit limit increase offers

Period of habitual minimum repayment	After 6 months	After 7-8 months	After 12 months	After 13-14 months
Customer journey	Customer receives initial notification regarding minimum repayment	Customer must expressly accept any offer of a credit limit	Customer receives follow-up notification regarding minimum repayment	Customer no longer offered credit limit increases

Monitoring and enforcement of the industry agreement

4.20 The industry is prepared to implement these measures on a voluntary basis. Monitoring of this agreement will be overseen by the LSB.

4.21 As the interventions are relatively straightforward for the LSB to monitor, providing us with relevant data will be straightforward. We can also monitor the impact of notifications and triggers on consumer behaviour and, if necessary, reconsider our approach to credit limit increases in due course.

4.22 The FLA has also agreed to implement these remedies in its Code to cover its members who will not be subject to oversight from the LSB.[21] The revised FLA Lending Code, which includes its own monitoring and compliance processes, will be published in May 2017.

Proposed implementation timeline

4.23 Implementing the proposals will likely require firms to make systems changes. The industry has committed to implement the full credit limit increases remedy within 12 months across firms representing around 85-90% of accounts, rising to 100% at 15 months.

4.24 In relation to restrictions on offers of credit limit increases, industry has committed to 70-80% within six months and with full coverage within a year. Some firms will also be able to implement the opt in requirements earlier.

Table 2: Implementation dates for the industry voluntary remedies on credit limit increases

	6 months	12 months	15 months
Greater control over credit limits		85-90% of accounts	100% of accounts

21 We are only aware of one such firm.

Restrictions on offers of credit limit increases	70-80% of accounts	100% of accounts

5.
Testing behavioural remedies to address under-repayment

In this chapter, we discuss the approach we are taking to testing remedies designed to address under-repayment, by changing the way repayment options are presented to customers.

Background

5.1 One of the CCMS findings was that groups of customers may not be making active choices when deciding how much to repay each month, but instead defaulting to the minimum repayment option, particularly when making repayments by direct debit. To address this, we have considered a range of potential options.

5.2 We are currently undertaking further research to determine whether changes to the way repayment options are presented, and the information customers have about the benefits of repaying quicker, can encourage customers to make more active repayment choices. We have conducted laboratory tests and are currently doing field trials, with the help of a number of lenders, to test different treatments. This includes testing the impact of removing the minimum repayment anchor by asking customers how much they would like to repay, rather than suggesting an amount.

5.3 Our objective is to prompt customers who could afford to repay faster to make an active choice over how quickly they want to repay their credit card debt. We hope to achieve a significant and sustainable reduction in the proportion of repayments at the contractual minimum and an increase in the value of repayments. The results of the trials will give us additional evidence on whether or not removing the minimum repayment anchor helps achieve that objective.

Behavioural economics & psychology of repayment decisions

5.4 Based on the framework set out in FCA Occasional Paper 1[22] and the academic literature reviews commissioned as part of the CCMS, the FCA is testing remedies based on the behavioural biases that we expect are likely to impact consumer credit card repayment decisions.

Anchoring

5.5 If consumers were 'economically rational', making decisions after accurately assessing all relevant current and future costs and benefits, their financial choices would be unaffected by how information is presented.[23] Literature on this topic indicates that consumers do not always appear to make economically rational decisions and are affected by how repayment

22 https://www.fca.org.uk/publication/occasional-papers/occasional-paper-1.pdf

23 Full details of the sources and academic literature for this chapter can be found in Annex 4 of the CCMS final findings report.

options are presented. In particular, consumer decision making can be affected by 'anchoring', whereby the presentation of particular pieces of information, which could be intended to help consumers' choices or may be random, heavily bias the decisions taken.

5.6 Research has shown that credit card customers' repayment choice appears to be influenced by the minimum repayment option, which anchors repayments downwards. This research finds that the lower the required minimum repayment, the lower the actual repayment made. It also finds evidence that the presence of a minimum repayment option being displayed has a large effect in reducing the repayment amounts. These effects are so large that additional disclosure alongside displaying the minimum repayment option does not eliminate the negative effects arising from the minimum repayment anchor.

Present-biased consumers

5.7 Behavioural literature has repeatedly shown how consumers often make decisions to provide gratification 'now' and postpone costs until later. Credit card customers are tempted to repay less of their debt now and put off repaying more debt until later with the result being increased interest costs of borrowing. Analysis of the US CARD Act disclosures on statements designed to address this issue found these only slightly increased repayments; however, there may be more salient ways to present information to be more effective.

Inertia and limited attention

5.8 Consumers can suffer from inertia (failing to take action) and inattention (having limited capacity for decision-making and possibly not paying full attention to the decisions they need to take). In the credit card market, we are concerned that groups of customers may not be making active choices of repayment amounts and instead defaulting to choose the minimum repayment option, particularly when making repayments via direct debit. This may result in high borrowing costs and limited paydown of credit card debts.

6.
Next steps

In this chapter, we set out the next steps on this consultation and other work that is taking forward CCMS remedies or is relevant to credit card firms in other ways.

This consultation

6.1 The rules and guidance on which we are consulting are in the draft instrument in Appendix 1. The consultation closes on 3 July 2017. During the consultation period we plan to engage with both industry and consumer stakeholders. We will then review the responses and publish our feedback, policy decisions and final rules and guidance.

6.2 We would intend to review the effectiveness of final rules after they have been fully implemented by firms and in operation for long enough to assess consumer outcomes.

Testing behavioural remedies to address under-repayment

6.3 Once the trials discussed in Chapter 5 are complete, later in 2017, we will consider the results alongside other evidence and decide the best way forward to achieve our objectives. Depending on what the evidence tells us, this could include consulting on rules requiring firms to present repayment options in one or more of the ways we are testing in the trials, or we may propose a different approach. The options we will consider may include increases to minimum repayments. We will also consider where any of our objectives could be achieved most effectively through an industry agreement. Any consultation that follows from this work is likely to be published in early 2018 and include any proposals we decide to make in relation to the advertising of 0% introductory offers discussed in Chapter 1.

Update on the industry agreement announced in the final findings report

6.4 In the CCMS final findings report, we announced that UKCA was putting in place a voluntary industry-led package of remedies to address some of the issues identified in the CCMS. These covered:

- **promotion expiry**, notifying customers when a promotional deal is about to end so they can consider their options, including shopping around

- **payment date changes**, informing customers that they can change the date their payment is due, helping them to manage their finances
- **borrowing prompts**, a digital notification to inform customers when their balance is getting close to their credit limit, helping them to avoid over-limit charges, and

6.5 The timelines for the industry agreement implementation have now been agreed, and they will be fully implemented as follows:

- promotional rate expiry: April 2018
- payment date changes: April 2018
- close to credit limit prompt: July 2018

6.6 The first two remedies will have an interim implementation rate of 95% in January 2018.

6.7 The LSB will monitor compliance with these standards. We will assess the effectiveness of this package over time. If any of these measures proved to be ineffective, we would consider further action.

Other consumer credit policy work

6.8 The remedies set out in this CP are limited in scope to the credit card market as they are aimed at addressing the specific concerns identified in the CCMS. The FCA is doing wider work to look at different areas of credit. For example, in November 2016 the FCA published a call for input on high-cost credit, including a review of the high-cost short-term credit (HCSTC) price cap[24]. We intend to publish a feedback statement in summer 2017 in which we expect to set out our plans for further work in this area. We are however mindful that interventions need to be carefully considered and, while lessons can be learnt looking across interventions in different areas of credit, we must consider properly their individual features – for example their different constituent product features and the customers they serve.

6.9 Three other current pieces of FCA consumer credit policy work are relevant to credit cards.

6.10 We are also planning to publish a CP soon – in the light of our experience of regulating consumer credit – proposing some changes to our rules and guidance on assessing creditworthiness (including affordability) to clarify our expectations of firms and promote responsible lending. This will be relevant to credit cards.

6.11 As part of the transfer of consumer credit regulation to the FCA, Parliament repealed some Consumer Credit Act provisions and some of these were replaced by FCA rules. Most of the CCA provisions were retained. We are required to review remaining CCA provisions and report to Treasury by 1 April 2019 on whether the repeal (in whole or part) of retained provisions will adversely affect the appropriate degree of consumer protection. Some retained provisions are relevant to credit cards.

24 https://www.fca.org.uk/publications/calls-input/high-cost-short-term-credit-price-cap

6.12 We published a Call for Input[25] in February 2016 asking for stakeholders views to inform the planning of the review. We have analysed these responses in detail to identify the key themes. These themes form the basis for planning our wider work and analysis that we plan to undertake to scope the review. We intend to publish a summary of the responses to the Call for Input in the first half of this year. We will also outline the scope for the review, and approximate timelines taking us up to 1 April 2019.

25 https://www.fca.org.uk/news/news-stories/call-input-review-retained-provisions-consumer-credit-act

Annex 1
List of questions

Persistent debt

Q1: Do you agree with our proposed definition of persistent debt?

Q2: Do you agree with our proposal for intervention at 18 and 27 months?

Q3: Do you agree with our proposals for intervention after 36 months of persistent debt for those customers that can afford to repay more quickly?

Q4: Do you agree that three to four years is a reasonable period over which firms must help customer repay the balance?

Q5: Do you agree with our proposals regarding a requirement to exercise forbearance and due consideration for customers in persistent debt who cannot sustainably repay more quickly?

Q6: Do you agree with our proposals regarding suspending use of the credit card?

Q7: Do you agree with our proposals for customers who do not engage at 36 months?

Q8: Do you have any views on the potential need for novation of existing contracts or modifying agreements in order to suspend or cancel customers' use of their card, provide forbearance or put in place a repayment plan?

Q9: Do you agree with our proposal that the firm must treat a customer with forbearance where the customer is unlikely to repay the balance in a reasonable period under a repayment arrangement?

Q10: Do you agree with our proposals for commencement of the Handbook provisions?

Q11: Do you agree with our proposals regarding overlap between persistent debt and earlier intervention and CONC 7.3.4R?

Earlier intervention

Q12: Do you agree with our proposal to require credit card firms to monitor other data in addition to a customer's repayment record?

Q13: Do you agree firms should be required to take appropriate action where there are signs of actual or possible financial difficulties?

Q14: Do you agree that signs of actual or possible financial difficulties should include where there is a significant risk of one of the matters in CONC 1.3.1G occurring?

Q15: Do you agree with the proposed examples in guidance in CONC on what may constitute appropriate action where a customer is showing signs of actual or possible financial difficulties?

Annex 2
Cost benefit analysis

1. FSMA, as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'.

2. This analysis presents estimates of the significant impacts of our proposal. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide estimates of outcomes in other dimensions. Our proposals are based on carefully weighing up these multiple dimensions and reaching a judgement about the appropriate level of consumer protection, taking into account all the other impacts we foresee.

3. This CBA has the following structure:

- Section 1 outlines our proposed interventions.
- Section 2 presents our market failure analysis.
- Section 3 lays out our estimates of the costs and benefits with respect to
  - Persistent debt; and
  - Earlier intervention.

4. Section 4 outlines our analytical approach to estimating costs and benefits of the proposed interventions.

Proposed interventions

5. The proposed interventions on which we are consulting are set out in paragraphs 1.22-1.32 of the Consultation Paper. In summary, these are:

- A remedy to require firms to monitor customers' repayment record for signs of actual or potential financial difficulties. Firms would be required to make reasonable efforts to contact customers identified and take appropriate action.
- A remedy to encourage both firms and customers to avoid credit card debt becoming persistent, and to help those customers who cannot afford to repay more quickly.

Market failure analysis

6. In this section we set out the market failures that our remedies look to address, which are based on our final findings published in Credit Card Market Study (CCMS).[26]

Overview of the market

7. The credit card market is large, with around 30 million customers[27] holding at least one credit card, together having an estimated £65.7 billion of outstanding balances[28]. If this market functions well, it can deliver significant benefits to customers, such as bringing consumption forward and spreading the costs of it over a number of months.[29]

8. In a market where competition is working effectively in the interests of consumers we would expect to see well-informed and active consumers who choose the available products that best suit their needs and use them in an optimal way.

9. The evidence and analysis set out in the final findings shows that competition is working fairly well for most consumers. However, we are concerned about the scale, extent and nature of problem credit card debt, and firms' incentives to manage this.

10. We found that in 2014 around 6.9% of cardholders (about two million people) were in arrears or had defaulted. We estimate a further two million people had carried a debt greater than 90% of their credit limit for at least 12 months, and that a further 1.6 million people were repeatedly making minimum payments on their credit card debt, while also incurring interest charges (i.e. excluding those on 0% interest deals). 8.9% of credit cards active in January 2015 (5.1 million accounts) would – if they maintained their repayment patterns and with no further borrowing – take more than ten years to pay off their balance.

Arrears

11. As set out in the final report, there is a clear concern that, when customers default or miss payments, the financial and non-financial implications in these cases are likely to be significant.

12. We recognise that some bad debt is a feature of all credit activity – borrowing is never risk-free, as the ability to repay is affected by major negative life events (such as divorce, redundancy or long-term illness). However, of the approximately 600,000 customers who ended up in severe arrears in 2014, two-thirds were categorised as being in some form of potentially problematic credit card debt state in 2013.

13. We think that firms could do more to identify customers at risk of financial difficulty earlier and take appropriate steps.

Persistent Debt

14. Many customers remain in persistent debt or continue making systematic minimum repayments for several years. As credit card firms note, credit cards are suited to short term borrowing and can be an expensive way to borrow large amounts over a long period.

26 MS14/6.3

27 Based on analysis of the CCMS dataset.

28 UK Cards Association 'Summary of key statistics for Q3 2016': http://www.theukcardsassociation.org.uk/wm_documents/Quarterly%20Market%20Trends%20Q3%202016%281%29.pdf

29 Brito, Dagobert L., and Hartley, Peter R., "Consumer Rationality and Credit Cards", The Journal of Political Economy, Volume 103, Issue 2 (Apr., 1995), 400-433.

Baseline

15. It is necessary to establish a baseline, or counterfactual, against which to assess the costs and benefits of an intervention to ensure that only those attributable to the intervention are considered.

16. In response to the firms' survey the majority of credit card firms cited EU regulation on interchange fees as having a notable impact on their business. As a consequence some respondents revisited their loyalty programmes and/or either introduced or increased their interest rates and fees.

17. In the final report we outlined a range of voluntary agreements with industry to address some issues we had identified in the interim report.[30] These include prompts before promotional periods end, providing timely information to prompt customers to take into account how much they are borrowing, and the ability for customers to request a 'later than' payment due date.

18. We consider that the above change in market conditions, relative to the period for which we have account level data, and our voluntary agreements with the industry, are targeted at different issues and so will not have a material effect on the scale of persistent debt or problematic debt states indicative of future arrears. Changes to interchange fees primarily affect the transaction side of the credit card rather than the borrowing aspect. Therefore, the relevant counterfactual here is the scale of persistent and problematic debt we observe in the credit card market in the absence of the FCA's interventions.

Market failures

19. In this section we summarise the relevant market failures presented in the final report that the proposed remedies seek to address.

Information asymmetry and misaligned incentives

20. Credit cards, like many financial products, are relatively complex products, and may be difficult for consumers to fully understand. Customers may not fully understand or appreciate the costs associated with credit card borrowing. For example, they may not understand the cost implications of repaying the minimum or how long it would take to pay off debts at this level.

21. Lenders do not have appropriate incentives to stop customers from over-borrowing and under-repaying. On the one hand, customers in default are extremely unprofitable, and firms are active in contacting customers who miss payments and triggering forbearance at this point. On the other hand, customers with persistent levels of debt, or who repeatedly make minimum repayments, are profitable for firms. Firms therefore do not have an incentive to intervene to address this behaviour until the borrower defaults, even though customers may be experiencing harm before that stage.

22. We think that by intervening at an earlier stage and taking appropriate action, firms could prevent customers from reaching this more problematic stage.

23. These information asymmetries and misaligned incentives can lead to customer harm. This may arise in the form of financial or non-financial harm, and may include very high cost of borrowing (in the form of high interest rates and fees) relative to the amount borrowed; the

30 Voluntary agreements with the industry are outlined in paragraphs 8.14-8.15 of the final report.

financial and non-financial consequences of default; the need to forgo essential expenditure; and personal distress.

24. In particular, customers may find themselves in situations in which they are using credit cards for long-term borrowing. Where lower cost alternatives are available, this is likely to be inappropriate. For example, customers with long term credit card debt may benefit from paying down their balance more quickly or converting their debt to a personal loan. We understand that personal loan option may not be available to or appropriate for all customers. For example, some customers may have a poor credit rating or value the flexibility of repayment that the credit card offers.

25. Firms have little incentive to suggest faster repayment options to their customers, as it is less profitable for them. We want to ensure the behaviour of firms in this sector align with good customer outcomes.

Biases

26. Even if consumers have all relevant information, they may not make rational decisions because of the presence of deep-rooted behavioural biases.

27. One of the academic literature reviews for the market study covered consumer behaviour and behavioural biases. It was published separately alongside the interim report.[31]

28. To summarise, we identified the following behavioural biases:

- Present bias – people may have excessive urges for immediate gratification, overvaluing present consumption over future consumption. As the consumer can regret such choices later, their preferences are 'time inconsistent'. Present bias can lead to self-control problems such as excessive consumption.

- Overconfidence – consumers are often overconfident about the likelihood of good events occurring or their own ability, including the accuracy of their judgements. For example, consumers often over-estimate their ability to repay their credit card debt, while under-estimating their future spending.

- Framing and anchoring effects – as people have limited attention, framing and salience can determine what information is processed and how that information is processed. Even when the economic benefits of particular choices are identical in two situations, consumers may make different choices depending on how the decision problem is framed, i.e., what it draws attention to. In particular, when making repayments on their credit cards, consumers may choose to make minimum repayments simply because it is one of the options suggested by the firms.[32]

29. In the CCMS we also noted a survey by *Which?* examining customers' understanding and perceptions of minimum repayments, which found that half of all minimum repayers (48%) thought that the minimum repayment level is recommended by their credit card provider. Such misunderstandings can lead to under repayment.

How our proposed interventions would address these market failures

30. The remedy on earlier intervention addresses the market failure that firms have the available information to identify those customers at risk of financial difficulty but do not necessarily

31 Literature review on behavioural biases is available here: https://www.fca.org.uk/publication/market-studies/review-credit-card-literature.pdf

32 See paragraph 5.10 on p.31 of the final report.

use it. Customers may not be aware that their use of the card is placing themselves at risk of financial difficulty. As firms may not have the incentive to intervene until financial difficulties materialise, the remedy will require firms to use their superior information at an earlier stage so reducing the market failure from the asymmetric information.

31. Credit cards are an effective way to smooth consumption in response to temporary shocks to income or unexpected expenses and avoid the transaction costs associated with multiple purchases. However, credit card lending is not suitable for borrowing over extended periods at high interest rates. Where, due to behavioural biases, lack of understanding or attention, or becoming financially stretched, cardholders use their card to borrow over extended periods firms do not necessarily have an incentive to intervene while the repayment on the account is profitable. The proposal on persistent debt provides incentives so that both firms and customers are encouraged to avoid credit card debt becoming persistent. When credit card debt does become persistent the proposal addresses that through changed repayment behaviour and/or forbearance. So cardholders are encouraged to overcome potential biases that can lead them to borrow over too long a time period and the incentive for firms to permit cardholders to repay in this way is reduced.

Cost and benefit analysis

Evidence base

32. To inform our assessment, we carried out a survey of 22 firms on the potential direct and indirect impacts of our proposal. Our sample covered the majority of the market and we consider that it is representative of the credit card issuers the remedies will apply to.

33. We considered this information together with the account-level data provided by credit card issuers throughout the market study. The data we collected are described in Annex 10 of the interim report, while the methodology for our analysis is set out in the Analytical Approach section of this Annex.

Summary of impacts: Persistent Debt and Earlier Intervention*

	Firms	Customers
Benefits	Faster repayment of credit card balances will reduce net lending so reduce cost of funding that lending.	Faster repayment of credit card balances and forbearance for those for whom increased payments are unaffordable is projected to reduce interest payments for customers in persistent debt by £0.3bn-£1.3bn per year.
	Reduced cost of arrears/default as stretched borrowers address their difficulties at an earlier stage.	Reduced incidence of arrears/default as stretched borrowers address their difficulties at an earlier stage. Benefits include reduced stress and avoiding negative impact on the credit score.
		Greater flexibility to deal with income or expenditure shocks once balances are paid down.
	Reduced costs from administration of arrears and debt collection.	*Reduced fees associated with lower rates of arrears and debt collection.*
Costs	Faster repayment of credit card balances will reduce interest revenue for firms by projected £0.3bn-1.3bn offset to the extent of any consequent increase in interest rates and fees on accounts. Revenue from interchange fees may also be affected.	Higher interest rates and reduced access to credit to the extent that firms change their lending decisions and/or level of interest or fees to recover lost revenue.
	Compliance costs, such as setting up new systems, employing extra staff, increasing correspondence.	
		Foregone consumption, as a result of borrowers setting aside funds for faster repayment, or due to suspension of card.
		Adverse effect on credit score and subsequent cost of borrowing if a report is made to CRAs.
	Impact on customer satisfaction from increased communication with customers who believe they are not at risk of financial difficulty.	*Time costs of engaging with the lender over repayment profile and/or the likelihood of arrears.*

* Earlier intervention in italics

Persistent Debt

Overview

34. This remedy aims to address the detriment to customers arising from the inappropriate use of credit cards, i.e. the use of credit cards for long-term borrowing. Such persistent debt is detrimental because customers may pay very high costs to service their debts. Moreover, persistent debt may be a sign that customers are trapped in a cycle of borrowing which they cannot afford to pay down. Our data suggest that customers in persistent debt are much more likely to exhibit signs of financial difficulty such as missed payments or very high levels of credit limit utilisation.

35. Persistent debt reflects misaligned incentives between firms and customers. Since customers with persistent levels of debt are profitable, firms have few incentives to address borrowers' repayment behaviour until the borrower starts to incur arrears. Only 50% of respondents to our firms' survey said that they had a process in place to identify customers who were in persistent debt.[33] Customers who fall into this category are usually contacted via letter, informing them of the costs of their borrowing behaviour and, in some cases, offering contact details of debt advice and support.

36. We consider that firms could do more to help those with persistent credit card debt to reduce debt burdens before they become problematic, and to prompt those repeatedly making minimum payments to repay quicker when they can.

Definition of Persistent Debt

37. The final findings of the market study defined two different states:

- *Persistent debt* – accounts that have an average credit limit utilisation of 90% or more while also incurring interest charges over 12 months; and
- *Systematic minimum repayment behaviour* – accountholders who have made nine or more minimum repayments, while also incurring interest charges over 12 months.

38. We have introduced a revised single definition of persistent debt for the purposes of this intervention to maintain a clearer focus on the cardholders that were running balances at high cost over a sustained period.

39. We considered whether these definitions were sufficiently capturing the behaviour relevant to our concerns. In particular we looked at two possibilities. The first possibility was that some customers would not be captured by the definition when they were experiencing persistent debt. The second possibility was that some customers defined as being in persistent debt, and so captured by the definition, were in fact using their card in a reasonable and efficient way.

40. We found that the definition used in the market study final report excluded some accounts that are likely to be of concern, such as those where repayments were above the contractual minimum but only marginally more than the minimum, so the rate of repayment was very low. The definition also excluded those accounts that were running a significant outstanding balance over a prolonged period, but perhaps because the credit limit was very high, did not have an average credit utilisation greater than 90%.

41. In addition, those customers who were facing low interest rates over all, or low or zero interest rates over a large part of the relevant period, such as customers on balance transfer deals, could be captured under the previous definition of persistent debt. However, for these customers maintaining a high balance and minimum repayments may be a rational approach and is not necessarily evidence that they are stretched or using the card inappropriately.

42. Also, customers who made regular minimum payments but occasionally paid off a substantial part of their balance would be captured by the old definition, even though this may be a reasonable repayment strategy for those with variable monthly income.

33 Those firms typically looked at consecutive minimum and low payments to identify consumers in persistent debt.

43. Given that there are many different repayment patterns that could be observed we chose to redefine persistent debt in terms of the impact on the cardholder rather than by the particular pattern of borrowing or repayment. In particular we focused on situations where repayment of principal is low, such that amounts of interest and charges paid are in excess of the principal being repaid.

44. We thus define an account as being in persistent debt if:

- Over a period of 18 months,
- payments of interest, fees and charges exceed repayment of principal; and
- the outstanding account balance is continually above £200.

45. This definition effectively takes into account factors such as the interest rate, cost of borrowing and the contractual minimum repayment on that particular account.

46. The calculated ratio of the fees and charges paid over a fixed period to repayment of principal (i.e. total repayments less fees and charges) over the same period gives us a figure in £ for the cost in interest and charges per £1 of principal repaid over the period.

47. For example, if on average over an 18 month period, a customer incurs interest and charges each month of £5 and pays £9 the ratio would be 1.25 as they have repaid less of the principal than they have paid in interest and charges (£90 in interest and charges and £72 in principal over the 18 month period). Our definition captures accounts where this ratio is above 1 in any 18 month period. A high ratio indicates that repayment of principal is slow and high costs are being incurred.[34]

48. We note that while we focussed on customers as the unit of analysis in the final report, customers were defined in a particular category based on the most severe state of any of the accounts they held. Here we are using the account as the unit of analysis for the purpose of this intervention. This is because credit card companies do not necessarily have information on other cards a customer may hold or have the ability to act in relation to those cards.

49. We also chose to define persistent debt over an 18 month period rather than a 12 month period, as in the market study report. This is because there is substantial seasonal variation in balances due in large part to Christmas but also seasonal income.

50. We propose to exclude accounts where the balance falls below £200 at any point during the 18 month period. This is to ensure we do not capture customers who have paid off all or almost all of their balance at some point in the 18 month period. There are also administrative costs of intervening with customers in persistent debt. For those with low balances the benefits of intervention are likely to be more than offset by those costs. In addition, minimum repayment rules typically include the provision that a minimum repayment cannot be less than £5 (unless the debt is less than £5). Once the £5 minimum is hit, typically at a balance of around £200, the ratio of the repayment of interest to principal reduces quickly.

51. Analysis of the CCMS dataset shows that there are around 4 million accounts in persistent debt at any given time. Each month between 220,000 and 250,000 accounts move into the state of being in persistent debt and a similar number of accounts leave the definition of persistent

34 Accounts in persistent debt under our new definition are typically paying approximately £2.70 in interest and charges for every pound they pay off their balance.

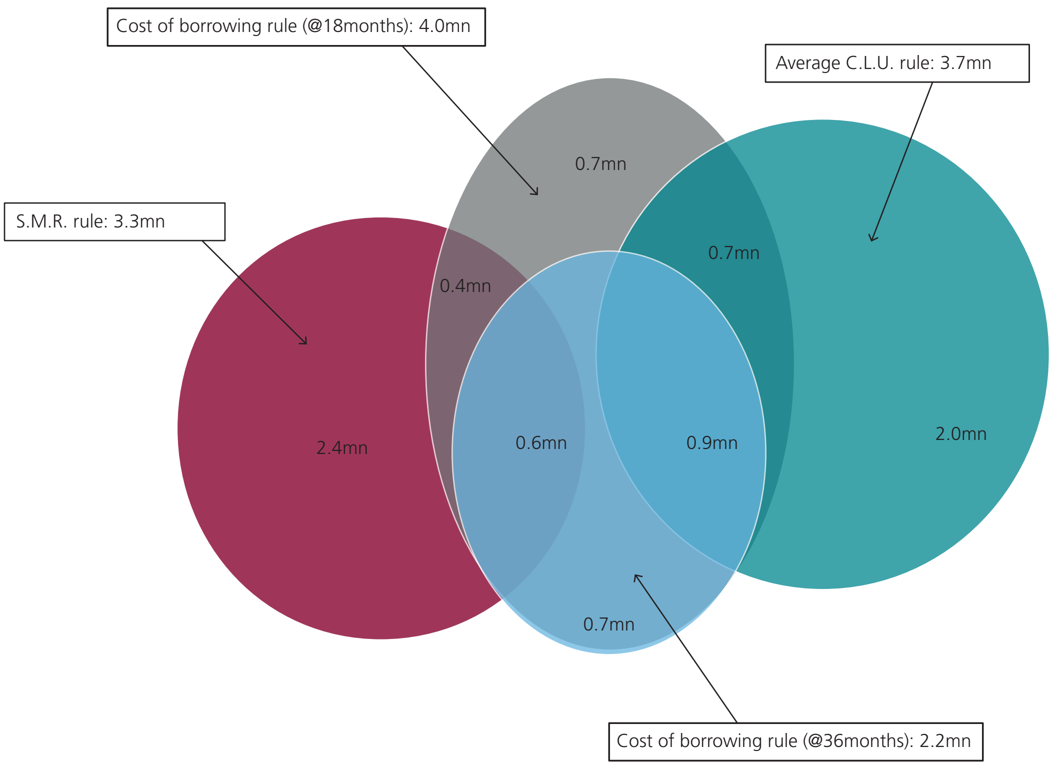
debt. We also looked at how many accounts identified as being in persistent debt in 2013 were still in persistent debt 18 months later to see whether accounts typically move out of the definition over that period. We found that more than half of accounts in persistent debt remained in the definition after a further 18 months.

The effects of the new definition

52. Because the new proposed definition is more targeted, fewer accounts would be affected than if we retained the definitions used in the final report.[35] However, overall we still estimate the proposed definition would capture 4 million accounts and 3.3 million customers (and of these, 2.2m accounts and 1.8 million customers 18 month later).

53. The diagram below shows the overlap between accounts that have repeated minimum repayments, high average credit utilisation or a high ratio of interest and charges to principal repaid. This shows that the vast majority of accounts captured by the interest and charges ratio also either incur repeated minimum repayments or have high utilisation or both. However, there are also many accounts with high utilisation or with repeated minimum repayments which do not meet the revised definition of persistent debt. These accounts may be on discounted interest rates or reflect features of the account that mean that the repayment behaviour is not as costly.

Figure 7: Comparison of the new and old definitions of persistent debt (December 2014)* [36]



* Scale is only approximate.

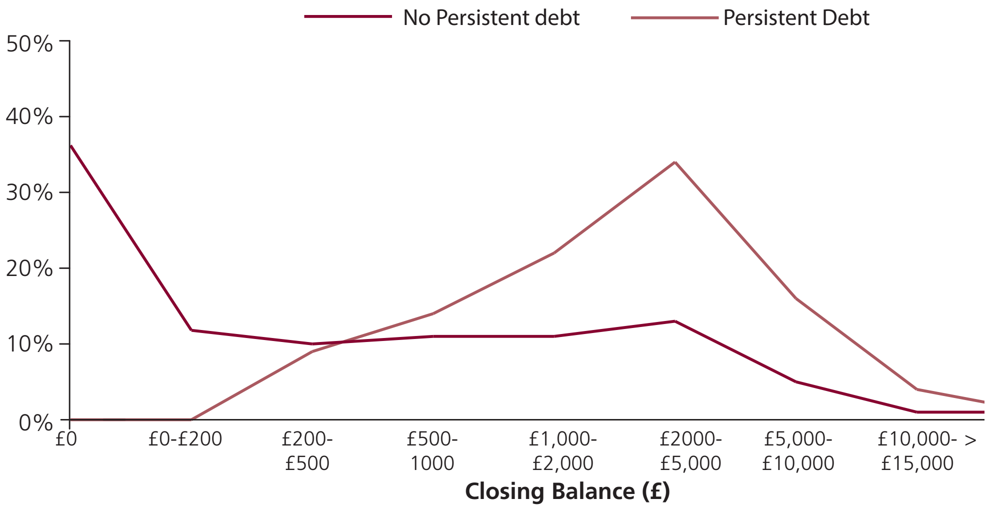
35 Slightly less than 40% of the accounts that would have been caught by the old definition are captured by the new definition. Although almost 70% of the accounts in the new definition are captured by the old definition.

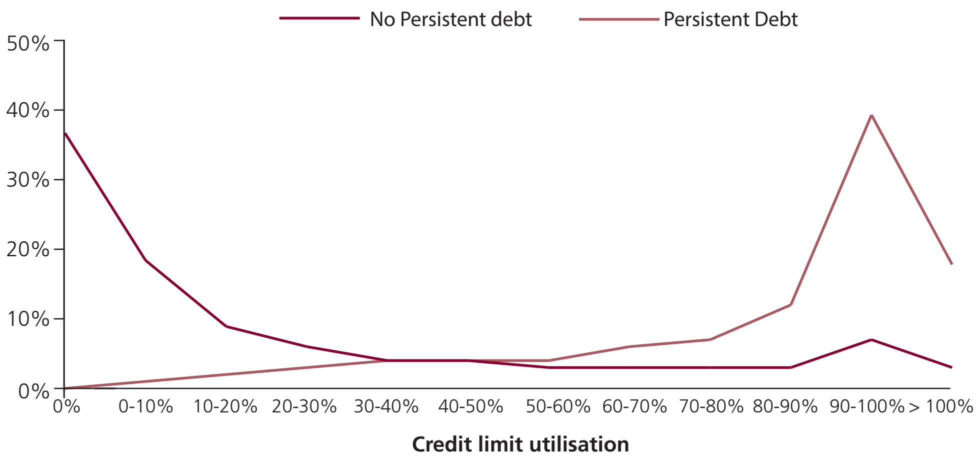
36 The systematic minimum repayment (SMR) rule and the average credit limit utilisation rule are based on the 'old' definitions used in the final report. These are compared with the 'new' definitions based on the cost of borrowing rules at 18 and 36 months.

Customer characteristics[37]

54. Accountholders who experience persistent debt have, on average, both higher balances and higher levels of credit limit utilisation than accountholders who are not in persistent debt. On average, an account which is in persistent debt has a closing balance of £3,464 and a credit limit utilisation of 82%. By contrast, an account which is not in persistent debt has, on average, a closing balance of £1,259 and a credit limit utilisation of 7%.

Figure 8: Summary analysis for accounts in persistent debt[38]





Source: FCA analysis of account-level submissions

55. Accounts in persistent debt also have higher debt service ratio and are more likely to miss repayments, have a CCJ, or go bankrupt.[39]

37 Figures are calculated for accountholders who are found to be in persistent debt after the Phase I assessment at 18 months.

38 Accounts in persistent debt at 18 months are depicted in this figure. The distribution is almost identical to the accounts that are still in persistent debt at 36 months.

39 In 2014, accounts in persistent debt were more likely to have missed multiple repayments compared with accounts that were not in persistent debt (33.9% compared with 7.1%, respectively). They were also more likely to have experienced a CCJ (5.1% compared with 1.4 %) and go bankrupt (0.2% compared with 0.1%).

56. An average customer in persistent debt has more credit cards than an average customer who is not in persistent debt. For example, 68% of customers who are not in persistent debt have only one credit card, while 51% of customers in persistent debt have two or more credit cards.

57. However, persistent debt is a concept that includes a diverse group of customers who are in persistent debt for different reasons and are experiencing different types and severity of harm. We distinguish broadly between two groups of borrowers in persistent debt:

- Customers who could afford to sustainably repay more on their card, and so pay down the balance faster and more cheaply, but are not doing so.
- Customers who can usually meet their contractual monthly minimum repayment but could not afford to pay more on their card.

58. People in the first category are not necessarily experiencing financial difficulties. However, this customer group may benefit from changing their behaviour, for example by making higher repayments, especially where low repayments are driven by inertia and misperceptions of the cost of borrowing and the alternatives.

59. The second group, on the other hand, suffer from an affordability problem, albeit one that is masked by their ability to maintain their current contractual payments.

Proposed remedy

60. The proposed remedy comprises a two-step approach as set out in detail in Section 2 of this consultation paper. In broad terms, when a borrower enters the definition of persistent debt the lender must contact the borrower to make them aware of their repayment behaviour and advise of the consequences if that repayment behaviour continues. If, when assessed in two consecutive 18 month periods, the borrower remains in persistent debt the lender is obliged to help the customer repay their balance more quickly. To this end, the lender should stop spending on the card unless an agreement has been reached with the borrower to sustainably maintain a higher level of repayments that would repay the balance in a reasonable period or unless such action would cause a significant adverse impact on the customer's financial situation. If such an agreement is not reached as the borrower either does not engage or the borrower is able to afford payments but declines to do so, the spending on the card is stopped. If a borrower confirms they are unable to afford to meet a repayment schedule that would pay down the debt in a reasonable period the lender should arrange a repayment schedule appropriate to the borrower's circumstance showing forbearance and due consideration. We expect that in most circumstances, firms would chose to suspend or cancel customers' ability to use the credit card if they are receiving forbearance.

61. The persistent debt intervention continues until the borrower has paid down principal equivalent to the outstanding balance at 36 months.

62. If a borrower's pattern of repayment is less than agreed and, if continued, will fail to repay the balance in a reasonable period, firms must offer forbearance.

Summary of impacts

63. The direct effect of the intervention once people enter the persistent debt state at 18 months is that some contacted borrowers will re-assess their repayment behaviour and increase the rate at which they pay off their balance. For these borrowers they will benefit from lower interest payments on their balance and lower balances.

64. Based on analysis of the market study account level data, we estimate that approximately half of accounts would exit the definition of persistent debt of their own accord in the absence of the intervention between 18 and 36 months. But we expect that, in particular as cardholders anticipate the possibility that spending on their card may be stopped at 36 months as a result of the intervention, more cardholders will either change their repayment behaviour or seek assistance if making higher payments is unaffordable. Alternatively, cardholders may refinance their debt or open other lines of credit.

65. For those borrowers that are in persistent debt state in two consecutive 18 month periods and are unable to sustainably meet repayments sufficient to repay within a reasonable period, firms are required to provide support and forbearance to enable them to achieve a sustainable repayment of the loan if feasible. As a result, cardholders who engage will repay their balance more quickly and so realise savings of interest payments on their balance. Some borrowers may respond to the stopping of their spending on the card by reducing expenditure or may have recourse to other forms of borrowing as a result.

66. In addition to interest savings, some customers will also benefit from having more flexibility in the face of income or expense shocks because of the additional available credit from paying down their balance. This will directly benefit customers who experience such shocks and provide peace of mind to a wider group of customers.

67. Firms will incur costs associated with identification of and communication with customers in persistent debt. Firms are also expected to respond to the loss of interest revenue to offset the effect on their profitability. Such changes could include an increase in interest rates to some or all customers, reduced availability of discounted interest rates, or changes to lending decisions. Such changes will indirectly reduce the direct interest savings of those in persistent debt, if those customers are affected. Alternatively, it may increase the cost of credit card use for customers not in persistent debt.

Effects on consumers

68. The objective of the remedy is to ensure that borrowers who are using their card in a way that may be inappropriate have this brought to their attention and so are able to address their repayment behaviour. Where borrowers are struggling to pay their debt, after three years, the intention is to crystallise this issue and, where customers are unable to make sufficient payments to pay down their balance, require firms to treat the customer with forbearance to enable them to repay the debt in a reasonable period.

69. We consider the intervention at 18 months (phase 1) and the intervention at 36 months (phase 2) separately.

Phase I (intervention at 18 months)

70. The objective of phase I of the remedy is to incentivise borrowers to voluntarily increase repayments on their debt. Customers will benefit directly from doing so by saving on interest charges and fees associated with debt repayment.

71. The impact at phase I will depend on the proportion of cardholders that engage with the intervention. On one hand, borrowers may be reluctant to engage with their repayment behaviour, because they face a cost of foregone consumption or reduced saving. That is, the money spent on debt repayments cannot be used towards spending on other goods and services, or savings.

72. On the other hand, there is an incentive in the opposite direction – to manage the repayments at a higher level in order to avoid losing access to the card. If customers respond by increasing repayments in phase I, they will avoid phase II of the remedy, thus retaining access to credit and the flexibility of deciding the level of their repayments.

73. For the purposes of estimating the magnitude of interest savings we identify a group of borrowers who are likely to be readily capable of increasing their repayments between the 18 month and 36 month periods. These are cardholders who both require a relatively small increase in repayments in order to avoid being classified as being in persistent debt, and incur no missed payments over the previous 18 month period. In developing our estimate we have taken into account data on customer response rates obtained as part of the firm survey we carried out in preparing this CBA[40]. These cardholders account for 11% of all cardholders who were in persistent debt for two consecutive 18 month periods.

74. We estimate that in total these cardholders would have outstanding balances of £815m. The interest savings for these cardholders are, on average, £993 as a result of the increased repayment, according to our estimates. The total future savings for these cardholders could amount to £240m spread over more than 10 years.

75. A significant proportion of accounts classified in persistent debt after 18 months are no longer in persistent debt after 36 months even in the absence of any intervention. They increase the level of repayment of their own accord. As a result of the intervention in phase I, we expect that a proportion of these accounts will increase their repayments earlier and to a greater extent than would otherwise be the case. Interest savings for this group depend on the likelihood of accountholders responding to communication in phase I and the time that those accounts remain in persistent debt before increasing their repayments. However, using simple assumptions[41] we would expect these cost savings accruing between the 18 month and 36 month assessment would be less than £10 million.

76. However, while we assume that these cardholders could increase repayments, they could also increase their spending commensurately, so keeping their balance the same as it would be in the absence of the intervention. In this case there could be zero interest savings for this group. Such complete offset on the part of all such accounts seems unlikely, but represents a lower bound for the interest savings for this group of cardholders.

77. Such offsetting expenditure may also occur once these cardholders exit persistent debt. That is, they may maintain a higher level of repayments and so achieve greater benefits in the future. But they may also reduce subsequent repayments or increase spending on the card that would partially, and could in principle completely, offset the additional repayments made.

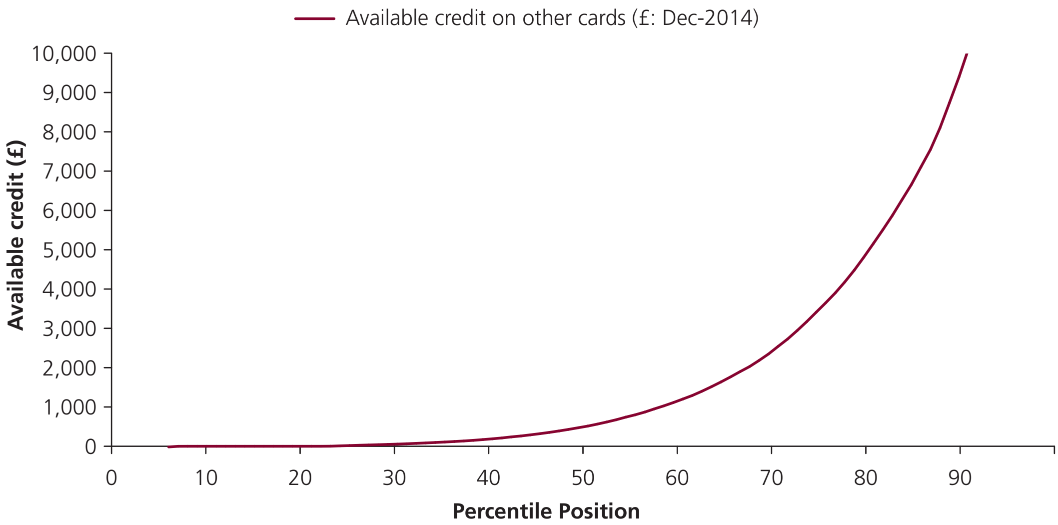
78. The benefits from interest savings need to be weighed against the cost of forgone consumption. There may be a very limited number of borrowers for whom their repayment pattern reflects unusual income or expenditure patterns so that prolonged repayment is desired. However, we do not expect there will be many situations in which making minimum repayments over a long period of time is, in fact, beneficial. Therefore, we believe that the net effect of increasing repayment will be beneficial for most borrowers. Furthermore, as Phase I involves only voluntary action by the customer, we do not think that this will lead to customers responding in ways that would put themselves in a worse position.

40 A large credit card firm respondent to the firm survey indicated that in a trial of a communication targeting customers holding debt for an extended period, 17% of customers responded by repaying faster or paying down the full balance.

41 In making this calculation we assume that 15% of 1.8 million accountholders would respond, and as a result of the intervention they would spend only 1 month in persistent debt. Any cost savings would result from the interest avoided as a results of the higher repayments. We assume that level of repayments increases to the level expected of an average account holder who exits persistent debt. We estimate that the average future savings to be approximately £30 per account, producing a total saving of £8.2 million.

79. Alternatively, customers who already hold multiple cards with available credit limit could, when faced with the future prospect of spending being stopped on one card, substitute to other cards and maintain their spending. This would allow the borrower to maintain a low level of engagement with their repayment behaviour. In Figure 9, we estimate the distribution of available credit on other cards once spending on the account in persistent debt is suspended. We estimated that 42% of these customers meeting the persistent debt definition had more than £1,000 available credit on other credit cards, while 10% had more than £10,000 available card credit. Some customers might also have an option to open an additional credit card account before or after the suspension of borrowing takes place.

Figure 9: Available credit on other cards



* To report on the basis of percentile position, observations are ordered from lowest to highest. An account at the 50th percentile is equal to the median estimate.

Source: FCA analysis of account-level submissions

80. Instead of engaging with the credit card provider, some customers may decide to refinance their debt through either a balance transfer or consolidation of the balance through a personal loan. This may reduce the cost of borrowing as typical personal loan rates offer lower rates of interest, as may a balance transfer.

81. A balance transfer may also allow the accountholder to defer dealing with unaffordable debt. If the existing credit card is retained it may also increase the available credit to the borrower and so could increase the overall debt burden. Some customers could also turn to alternative, potentially higher cost, forms of credit or sacrifice essential expenditure, such as utility bills, in order to increase their credit card repayments in response to the prospect of the suspension of borrowing. However, as such a suspension is far from certain, and the remedy requires that firms encourage customers to contact them in case higher repayments are unaffordable, we do not expect many of customers to react this way in Phase I.

Phase II (intervention at 36 months)

82. The objective of Phase II of the remedy is to require firms to help borrowers who are struggling to repay their credit card debt by arranging a payment schedule that is appropriate to their circumstances. As in Phase I, customers will obtain savings on interest charges and fees associated with debt repayment, but may also engage in offsetting expenditure.

Illustrative repayment schedules

83. Firms are expected to develop repayment options to offer to customers in persistent debt. We have developed repayment schedules for the purposes of estimating potential interest savings and compared those to the counterfactual scenario.[42] These illustrative examples do not represent a prescription of schedules that firms are required to offer to their cardholders.

84. For the purpose of modelling interest savings we consider two groups of accountholders of those who remain in persistent debt after 36 months. First, those who have kept up to date with their payments, with the potential exception of one missed payment. As these accountholders do not appear to have problems affording their current repayments, we assume that increased repayments would be affordable to this group of accountholders. Second, we assume that those accountholders who have missed multiple repayments over the previous 18-month period are stretched borrowers, and might, therefore, be unable to affordably increase their repayments. Neither group includes cardholders that are currently more than one month in arrears.

85. We estimate that the first group of accountholders accounts for 63% of those in persistent debt after 36 months and hold outstanding balances of £5.2bn. For this group we adopt a scenario where accountholders are offered a repayment schedule that, with no further spending, would pay down their balance over 3 years if the balance is less than £5000 or in 4 years if the balance is at least £5000. The accountholder is assumed to repay the principal as of when the repayment schedule came into effect.

86. As accountholders adopting these repayment schedules would most likely retain spending on their card, we consider that there will be a partial offsetting effect.

87. We also recognise that some accountholders will not engage with their credit card lender or will not agree to repay more quickly. For the purposes of estimation we, therefore, scale the estimates of savings downwards to reflect the uptake of repayment schedules, as well as the rate of offsetting spending described above.[43] [44]

88. In December 2014 the average balance of this group of borrowers, i.e. those that we assumed could affordably increase their repayments, was £3,824. The average interest rate was 26% and the average contractual minimum repayment was just under £100. A repayment schedule that would pay off such a balance within 3 years at the same interest rate would require a fixed monthly repayment of £154 – an increase of £57 on the original minimum payment.

89. The second group of cardholders we consider are those that have missed more than one payment over the previous 18 months, but have been able to make up those payments and so have avoided arrears. We assume that these accountholders would be unable to affordably increase their repayments to pay off the current balance within 3 to 4 years. This group amounted to 571,000 accounts in December 2014 with total outstanding balances of £1.85bn.

42 We first consider what would happen if there were no intervention, i.e. the counterfactual scenario. One plausible scenario is that accountholders would continue the pattern of repayment they have adopted for the previous 18 months. However, we observe that some accountholders increase their rate of repayment after a period of being in persistent debt and so exit the state of persistent debt, while others go into arrears. The counterfactual scenario is, therefore, likely to overstate the interest fees and charges incurred by the accountholder. Comparing the result of our intervention against this counterfactual would overstate the savings to consumers, and lost interest to firms. We, therefore, also compare against an alternative scenario where future repayments made by an accountholder are higher, on average, than we currently observe.

43 This is equivalent to assuming that half of cardholders offset their increased repayments fully by spending and equivalent amount on their card, while half of cardholders do not offset at all.

44 Evidence from the US suggests that some consumers are prone to offset their debt repayments with new spending. See Kutchler, T, “Sticking to your repayment plan: empirical evidence on the role of present bias for credit card paydown”. This evidence relates to a repayment plan that the customer has elected and so is not strictly comparable to the repayment schedules under the intervention.

90. If such accountholders were to have their spending stopped and were to fix their repayment at the level of the current minimum repayment, they would pay down their balance faster than if the minimum repayment declined with the balance as it usually does. For typical credit card interest rates, maintaining a fixed payment at the current absolute level of the minimum repayment and not spending more on the card will result in the balance being paid off within 5 years.[45] As the accountholder is not consistently meeting current repayments, it appears likely that some level of forbearance may be required to ensure that the balance is repaid within 3-4 years. Accordingly, we model savings for such accountholders including such levels of forbearance.

91. We estimate that 41% of these cardholders have existing credit cards with available balance and they may divert spending to other cards which would offset the estimated savings from the repayment schedule. However, we note that such cardholders would face a constant absolute repayment amount, so no additional monthly expenditure would be required on the part of the accountholder. We, therefore, do not consider that there is a significant incentive to divert spending to other cards if available. We also recognise that this group of accountholders are likely to have less access to new forms of credit than those who are more consistently meeting their repayments, due to their lower creditworthiness.

92. We note that, in principle, the potential of a borrower receiving forbearance could provide the incentive for some borrowers to remain in persistent debt rather than increase their repayment. We do not believe that this incentive is large and many borrowers would consider this course of action. There is no guarantee of an interest rate reduction for those in persistent debt. It would be based on assessment of the borrower's ability to afford higher repayments. Furthermore, in order to benefit from some forbearance from the lender the borrower would likely have to accept a spending restriction on their card and the forbearance may be recorded on the borrower's credit file. Therefore, we do not consider that the remedy gives the incentive for borrowers to 'game' the system in this way.

Outcomes for customers

93. At the point at which the rules become operational there will be a large stock of accounts, we estimate 4 million that will meet the definition of persistent debt as assessed over the previous 18 months. By the time of the phase II assessment, 18 months later, we expect that that 2.2 million accounts from this initial stock will still be in persistent debt. In addition, each month new accounts will be captured by the definition. Based on the account data up to 2015 we estimate that initially the flow of new accounts into persistent debt after two consecutive 18 month period assessments will be 50,000 per month. However, we expect that as the rules come into effect and firms and accountholders adapt to the new rules that number will fall. The scenarios described above, therefore, have been applied not only to an estimate of the current stock of accountholders, but also the future flow.

94. By far the largest interest savings to accountholders come from increasing repayments by relatively modest amounts above the current minimum repayment level. We recognise that the magnitude of the savings depends upon a number of factors, including how accountholders would continue to use their card.

95. The repayment schedule applied to the first group of accountholders, i.e. those that we assumed could affordably increase their repayments would substantially cut the interest paid over the lifetime of the balance. In our upper bound scenario the average interest saving for

45 Current statutory minimum repayment required is equal to the interest fees and charges plus 1% of principal.

these accounts would be £2,248 and the total interest saving would be £6.9bn spread over a number of years.[46]

96. As with accountholders who respond prior to the 36 month point, any interest savings from higher repayments could be completely offset by additional spending on the card. As a result, the interest savings for this group could be zero. However, such complete offset by all accountholders seems unlikely and represents a lower bound on the direct interest savings.

97. The aggregate potential savings for this group are significant. They are small in the initial period of the remedy and gradually increase to a roughly steady amount approximately 5 years after the rules come into force.

98. We now consider the second group of accountholders, i.e. those that we assumed would be unable to affordably increase their repayments. We estimate that the average interest saving for these accounts would be £3,424 and the total interest saving would be £5.5 bn.

99. Figure 14 to 17 in the Analytical Approach section illustrate the savings made by the different groups.

100. As in Phase I, there is a cost to customers of faster debt repayment, which is forgone consumption or reduced saving. However, Phase II does require customers to make arrangements for repayments. As such, some customers may revert to other means of borrowing, such as payday loans, to cover the increased repayments. However, firms are required to assess whether the borrower is able to sustainably repay more and we do not consider that the additional repayments required in Phase II would require borrowers to forego essential expenditure.[47] There are also exceptions that would allow the borrower to continue spending on their card.[48] As set out above, firms are also required to propose arrangements to make repayments affordable, applying forbearance such as lowering interest rates where appropriate. We believe that this flexibility will help mitigate customer harm arising from the increased repayments and/or the cessation of spending on the card.

101. An additional Phase II cost to customers is incurred when borrowing is suspended. How costly this ultimately is depends on the individual and the implication for their credit score if a report is made to CRAs. We consider several types of customers:

- Customers not spending on their credit cards;
- Customers with multiple credit cards and free balances available on a credit card other than the one on which borrowing is suspended;
- Customers with one credit card, in the position to apply for another credit card;
- Customers with one credit card, not in the position to apply for another credit card.

46 These costs savings which accrue to the group who can afford the revised repayment schedule are estimated for both the existing stock and cumulative new flow forecasted out to 2030.

47 If customer's circumstances change due to a life event and payments become unaffordable this will be dealt with via Earlier Intervention proposal and firms' current forbearance policies.

48 In its 2010 paper, Oxera analysed the effects of increasing the required minimum payment. The survey evidence cited in its paper showed that 39% of consumers making minimum payments said that they would still be able to make minimum payments if the rate were doubled; 51% identified that they either 'might' or 'would definitely' find it difficult to meet the increased minimum repayment; and 10% said that they already incur difficulties in meeting the minimum payment. Oxera noted that these figures were likely to be inflated by the economic downturn. An economic assessment of BIS's proposals for credit card regulation, Oxera, January 2010

102. For the first group, suspension of borrowing is unlikely to be a concern. For the second and third groups, suspension of borrowing is also unlikely to be problematic, though there are limitations to the success of the remedy when customers have multiple credit cards. This was discussed above.

103. The final group is of the most concern. Harm may come to these customers if the suspension of borrowing on their credit cards forces them to curtail essential spending or default on non-credit card payments. In particular, further harm may come to these customers if they turn to more expensive credit options.

104. Borrowers will also experience costs to the extent that changes to payment schedules, suspension of borrowing, and in particular forbearance measures, adversely affect their credit score and may affect their future ability to obtain credit.

105. Finally, a secondary cost to customers may occur if the remedy leads credit card providers to change their lending decisions. Saving for customers translates into a loss of revenue for firms. We considered the possibility that this may lead to firms changing their lending decisions, which, in turn, could lead to some customers facing higher interests rates, and limit other customers' access to credit. This effect may be focused on certain customers if firms are able to identify customers who are more likely to engage in persistent borrowing. Firms' profits will be most affected for these customers, and therefore the increase in interest rates or reduction in credit access may fall most on them. To the extent that the effect is to deter lenders from extending credit to people who would become over-indebted and unable to pay down at a rate normally expected of credit card borrowing, borrowers will benefit.

Scale and timing of savings (from Phase I and Phase II interventions)

106. In our scenarios we estimate that the direct effect of increased repayment by cardholders could yield annual interest savings of a maximum of £1.3bn per year and the lower bound of direct interest savings is £310m per year. This is not a strict upper bound on the interest savings – the savings would be greater if accountholders do not engage in any offsetting spending and all engage fully with the intervention. However, given realistic assumptions on behaviour, we consider that this is likely to be the upper bound of the likely savings.

107. In practice offsetting spending may mean that the direct interest savings could be substantially smaller and closer to the lower bound. The savings will not be evenly distributed through time – they will be smaller in the initial years of the intervention and will grow over a number of years before declining and then reaching a steady level. In addition, as discussed below, firms may be expected to respond to the loss in interest revenue by increasing interest rates or otherwise changing their charging structure or lending decisions. A resulting increase in interest rates affecting those customers in persistent debt would lead to a reduction in the level of interest savings cited above.

108. In addition to interest savings, some customers will also benefit from the peace of mind that comes with having more flexibility in the face of income shocks. As customers come out of persistent debt, their credit limit utilisation will decrease, giving them more headroom to deal with income shocks, should they need to in the future. This will benefit those customers who currently have high credit limit utilisation. We estimate that 85% of those accounts that have been in persistent debt for 36 months have credit limit utilisation on their account that exceeds 50%. Half exceed 90%, and so are effectively 'maxed-out'.

Effects on firms

109. As discussed above, the direct effect of faster repayment and forbearance for some customers is a loss of interest revenue for firms. The scale of this loss of interest depends on the same factors that influence the projected savings for customers considered above. The lost interest to credit card firms will be similar, but not identical, to the savings for cardholders. If cardholders offset higher repayments on one card with higher spending on another card then credit card firms as a whole will receive the same loss of interest as the overall savings, net of offset, experienced by cardholders but there may be some redistribution between credit card firms. If cardholders respond to higher repayments on their credit card by taking out or using other non-credit card debt or credit lines such as overdrafts, the savings to cardholders will be less that the losses to the credit card firms as a whole. This would represent a benefit to other non-credit card credit providers. We have not attempted to quantify the scale of this substitution to alternative forms of finance.

110. In the case of faster repayment there will be a loss of interest revenue but also a lower cost to firms as there will be lower net lending due to the faster repayment of the outstanding balance. This will imply a reduction in profitability that will depend on the margin between the interest rate and the cost of funding for such lending. Forbearance will likely involve a reduction in interest received on outstanding balances although such forbearance would also lead to the outstanding balance being paid more quickly, and so lower lending.

111. In the assessment in the credit card market study we found that all customer groups, including those in persistent debt, 'transactors' who run no balance, and other cardholders who run interest bearing balances but are not in persistent debt, are profitable. The exception is customers in arrears – they are unprofitable. Therefore we expect that cardholders who increase their rate of repayment will remain profitable for firms. For customers who cannot afford increased monthly repayments, and are offered forbearance, there would be a reduction in the expected profitability of these accounts and so lending decisions and the terms of lending by firms to customers expected to be in this position may well be affected.

112. In addition the intervention may change the level of spending on credit cards which will affect the interchange fee revenue that firms receive. On the one hand, we estimate that the stock of customers who cannot afford to increase repayments, and so will have spending on their card stopped, would have spent £300m per year on their card. This would yield approximately £1m in interchange fee income at the prevailing rate of 0.3%. However, customers who retain access to their cards may compensate for higher repayments by increasing spending which may lead to higher card spending overall – so it is possible that net interchange fee income could increase as a result of the intervention.

113. The projected scale of interest reduction, including forbearance, of between £310m and £1.3bn per year represents a material reduction in interest received by credit card companies. Some firms have a higher proportion of accounts that will be affected by the proposals and so their revenue will be proportionately greater affected. Therefore, we would anticipate that firms would respond to the reduction in interest received and the impact of the overall profitability of their credit card business. There are a number of ways in which firms could respond, such as reducing availability of promotional interest rates, increasing general interest rates, and/or changing decisions on the availability of credit.

114. There is mixed evidence of the scale of offsetting changes in response to interventions that reduce the fees for credit card customers who may be showing signs of financial difficulty in the UK and US. In the UK in 2006 the level of the fee for late payment was reduced by a number of credit card issuers following a statement by the OFT which identified excess payments of £300m per year.[49] Issuers were reported at the time to have increased interest

49 Calculating fair default charges in credit card contracts: A statement of the OFT's position, April 2006, OFT842

rates on their credit cards in response.[50] Effective credit card interest rates as measured by the Bank of England also increased in the months following the change.[51] However, such interest rates were rising gradually over a period of 5 years, including three years prior to the OFT's statement and 18 months after the announcement. Therefore, it is difficult to quantify the effect of the OFT's statement relative to changes in general economic conditions.

115. By contrast, an evaluation of the 2009 CARD Act in the US which reduced fees on credit cards found that the intervention saved consumers $11.9 billion a year but found "no evidence of an offsetting increase in interest charges or a reduction in the volume of credit".[52]

116. While they related to changes to credit card products, in the case of the evaluation of the US relate to a different regulatory framework and these interventions differ from the proposals in this consultation paper. Those proposals cut the level of a fee. The effect of the current proposal is largely to reduce outstanding balances on which interest is paid rather than reduce the level of interest rate per se. Therefore, even if firms were to increase interest rates to a level to restore the level of profit before the intervention, this would not completely offset the direct interest savings for customers we estimate. Firms would only need to increase interest sufficiently to cover their net loss in interest after funding costs, whereas consumers receive the entire reduction in interest.

117. Overall, these examples indicate that the range of potential responses by firms is wide and highlight the difficulty of accurately quantifying likely responses by firms.

118. Firms will inevitably incur compliance costs, such as setting up new systems, employing extra staff, increasing correspondence, etc. We conducted a market-wide survey of the expected compliance costs to inform our CBA. In response to this survey, firms have indicated that the one-off costs of setting up and running a function to identify customers who are in persistent debt and intervening to help them will vary from £5,000 to more than £1m, with the weighted average one-off cost being £700,000 per firm.[53] Ongoing costs varied from £6,000 to more than £3m, with the weighted average ongoing cost being £1.9m per year, per firm. We estimate that the one-off cost to the industry will total £7.2 million, and the annual ongoing cost will total £20.6 million.[54]

Costs to the FCA

119. The cost to the FCA resulting from this proposal is the opportunity cost of FCA resource being employed to supervise and enforce the rule. Otherwise this resource could be employed elsewhere.

Summary

120. The proposed remedy to address persistent debt addresses situations where borrowers use their credit card for prolonged borrowing, either through inattention or because they are unable to afford to pay down at a faster rate. The proposals provide firms and borrowers

50 Banks to cut credit card charges BBC News 1 June 2006,

51 Bank of England data series: Sterling weighted average interest rate credit card loans to households. CFMHSDG

52 Regulating Consumer Financial Products: Evidence from Credit Cards, S. Agarwal, S. Chomsisengphet, N. Mahoney, J. Stroebel, Quarterly Journal of Economics (2015) 130 (1) p111-164.

53 Weighted by the number of customers in 2015.

54 Collectively, the firms that responded to this part of the questionnaire represent approximately 40% of all accounts. To estimate the expected compliance cost, we estimated the weighted average cost per account, and then scaled these to the market. Although there was a wide range in the estimates provided by firms, we calculate one-off costs of £0.13 per account, and ongoing costs of £0.37 per account. Using data from a CRA, we estimated that there were approximately 56 million accounts registered open in January 2015. Scaling to the market we calculate total one-off compliance costs of £7.2 million and annual ongoing compliance costs of £20.6 million.

with the incentive and ultimate requirement to address such borrowing if credit card usage is to continue.

121. The proposals are expected to yield interest savings to those in persistent debt who are enabled to pay down their outstanding balance more quickly. Although cardholders who increase their repayments will lose the benefit of immediate consumption or savings they forego as result of increased repayments, such cardholders are typically expected to experience net benefits. It would only be in exceptional cases that a cardholder would be expected to rationally pay down their credit cards at the cost and slow rate of those classified in persistent debt for an extended period of time.

122. The proposals are also expected to reduce the incidence of default as borrowers in financial difficulties will address those difficulties at an earlier stage. There are also expected to be some adverse effects for borrowers who have their credit card spending stopped or for whom the intervention impacts their ability or the terms on which they obtain credit in the future. On balance we consider that the proposals will be net beneficial for borrowers.

123. The scale of direct interest savings for cardholders will depend on how cardholders in persistent debt adapt their repayment behaviour and spending in response to the intervention. We project that the direct effect would be a saving in interest payments that will increase over a number of years and peak at between £310 million and £1.3bn per year. There may also be a small change in the level of interchange fee income as a result of the proposals.

124. However, firms may respond with changes to interest rates and/or lending decisions which would reduce the net effect of these savings. As well as experiencing a fall in interest revenue, firms will also experience a fall in net lending with a commensurate reduction in funding costs, so we do not expect that a potential increase in interest rates would fully offset the interest savings. Such an increase in interest rates by firms may be targeted at those accounts most likely to be in persistent debt or may impact more widely on cardholders.

125. Having considered the various impacts we recognise that the magnitude of the impacts will depend on how customers and firms respond to the proposal and are subject to a significant degree of uncertainty. However the analysis set out here provides the basis to believe that this is a proportionate proposal that is expected to yield net benefits to cardholders in persistent debt.

Earlier Intervention

Overview

126. This remedy aims to prevent customers from going into financial difficulties by identifying these customers earlier, before they start to miss payments and their situation worsens. The market study findings demonstrated that there are incentives for firms to prevent customers from defaulting, as these customers are not profitable for firms. In addition, we consider that credit card firms have the ability to identify customers earlier, before they get into financial difficulties.

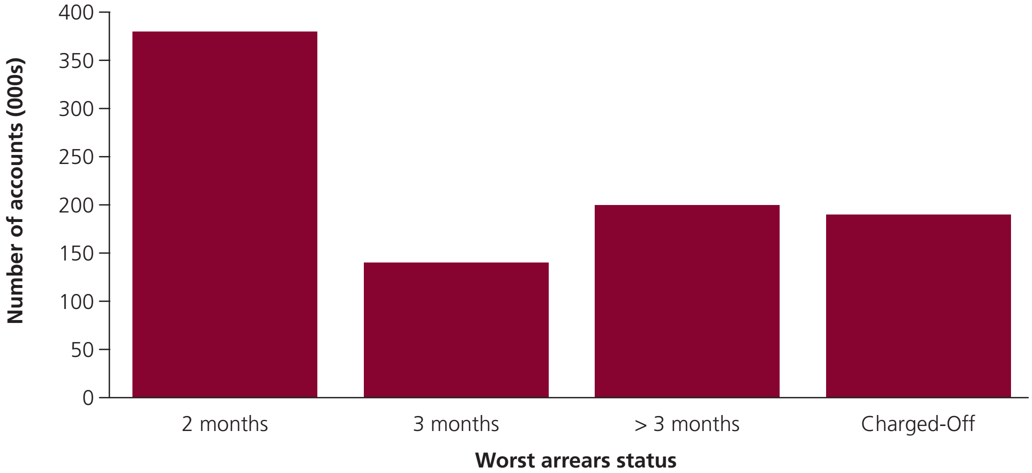
127. The financial and non-financial implications of customers in financial difficulties are likely to be significant. More specifically, this remedy aims at addressing the following detriment:

- The consequences of missing repayments, such as late/default fees and extra interest that is applied to these fees and balance that would have otherwise been repaid.

- The withdrawal of promotional rates on the credit card, such as 0% interest rates, which may follow missed repayments in some cases.
- The consequences of default (charge off) for a proportion of customers, including lower credit score and potential inability to borrow.
- Customers' personal distress due to being in arrears and, in some cases, defaulting.

128. This problem affects a substantial number of customers. Of all those accounts which were up-to-date with payments at the start of the year 2014, approximately 2% subsequently experienced arrears of two or more consecutive months. This is approximately 910,000 accounts that experienced harm as a result of arrears.

Figure 10: Distribution of accounts experiencing arrears*



* By the worst arrears state we refer to the maximum number of monthly cycles overdue an account has been at any point. For instance, an account with a worst arrears status of 2 months has been no more than 2 months overdue in 2014, even though they may have missed more than 2 payments over the course of 2014.

Source: FCA analysis of account-level submissions

Definition

129. Our proposal requires firms to take appropriate action where there are signs of actual or possible financial difficulties in relation to a credit card customer.

Proposed remedy

130. Our proposed remedy would:

- Require firms to monitor a customer's repayment record and other available data to identify actual or possible financial difficulties.
- Require firms to establish, implement and maintain an adequate policy for identifying and dealing with customers showing signs of actual or possible financial difficulties, even though they may have not missed a payment.

131. We do not propose to require firms to use a particular methodology to assess the signs of actual or possible financial difficulties, to specify the particular risk factors to use, or how and when firms should intervene, as firms are better placed to develop their own approaches given the diversity of firm models and customer portfolios.

Summary of impacts

132. The primary impact will be to reduce the number of borrowers who get into financial difficulties and to lessen the adverse effects or severity of those financial difficulties due to earlier intervention.

133. As a result of the earlier intervention firms will avoid some administrative costs of dealing with arrears and collection of debts that are charged off. Customers will avoid the charges levied by card companies to cover such costs as well as any additional interest they would incur as a result of late payment.

134. Indirect benefits to customers also include any reduction in stress experienced due to avoiding financial difficulties and not being subject to debt recovery practices. Customers may also avoid adverse effects on their credit score that would affect their ability to obtain credit in future and the cost associated with credit they do obtain.

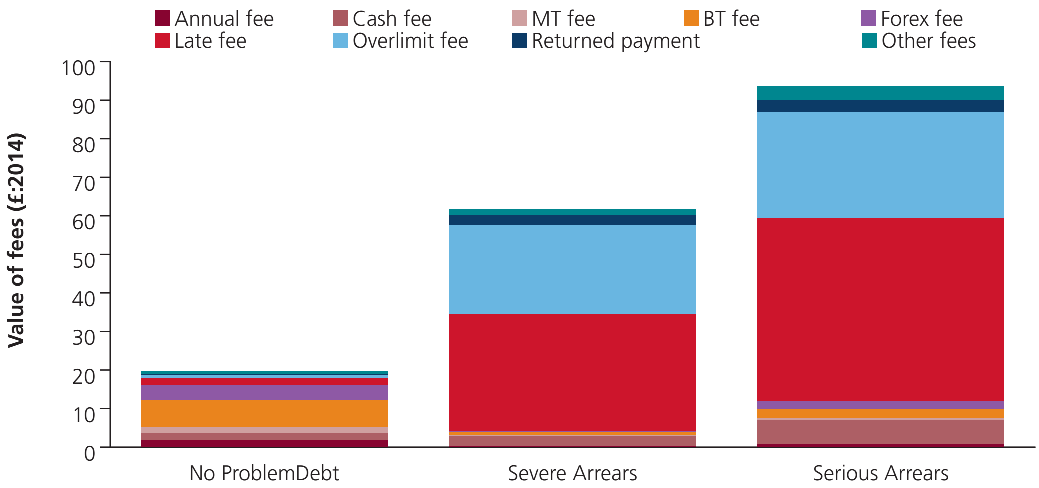
135. Using account level data on charges and interest faced by those in financial difficulties we have been able to estimate the per customer costs of charges associated with being in financial difficulties and estimate the market wide scale of those costs. This estimation of the potential scale of the benefits is described in the Analytical Approach section from paragraph 157. While we assess the indirect effects mentioned above we have not found it reasonably practicable to estimate the monetary value of those benefits.

Effects on consumers

136. One of the benefits to customers from this remedy will be in the form of savings made by avoiding charges or interest associated with being in financial difficulty. We estimate that the direct cost of arrears – measured in terms of the arrears fees and interest – incurred is within the range £14 to 70 million. The reduction in such costs to firms and fees to cardholders will depend on what proportion of customers that would get into financial difficulty are prevented from doing so by the earlier intervention. This depends on the ability of firms to identify actual and potential financial difficulty and the effectiveness of steps to prevent that from materialising.

137. The chart below compares average annual fees for accounts that are not in problem debt with those that are in arrears. It is clear from the chart that accounts in arrears pay four to almost five times more per year than accounts that are not in problem debt. The chart also shows that a significant proportion of these fees comes from late and over-limit fees.

Figure 11: Estimate of the average fees by account[55]



Source: FCA analysis of account-level submissions

138. In addition, being in financial difficulty increases the probability of debt charge-off and increases the cost of credit. As such, by avoiding financial difficulty, some customers will also avoid their debt being charged off, with all related benefits.

139. These benefits include avoiding a County Court Judgement and a decreased credit score, which could lead to an increase in the interest rate on new credit and, at the extreme, inability to borrow.

140. Last but not least, avoiding financial difficulty and, in some cases, debt charge-off, will also lead to reduced level of stress for customers. Due to the nature of the stress and its effects we do not believe that it is reasonably practicable to estimate in monetary terms the benefits of avoiding such stress.

141. Although we expect that there will be benefits to customers from addressing any financial difficulties earlier there are also some likely costs to customers.

142. There will be some customers who are identified at risk of financial difficulty who would not have experienced such difficulty and would have managed their repayments independently. For these customers there will be an inconvenience cost of being contacted by the lender and for any subsequent engagement with the lender. The number of customers falling into this category will depend on the accuracy of firm's processes for identifying customers at risk of arrears and the circumstances under which firms decide to contact the customer. However, we anticipate that for those people the inconvenience cost will be low.

143. For customers at risk of financial difficulty in the near future the expectation is that once they have been identified by the lender the steps taken by the lender will assist in avoiding the costs of financial difficulty. We recognise that for some customers there may be unintended consequences. For example, as a result of engagement with the lender customers might prioritise paying down the balance on their credit card debt while sacrificing essential expenditure, such as utility bills. However we expect that for those borrowers that are identified at risk of financial difficulty the intervention by the lender will be on balance beneficial to the borrower.

55 Account types, i.e. 'no problem debt', 'severe arrears' and 'serious arrears', are based on the problem debt definitions which the FCA used in the Credit Card Market Study.

Effects on firms

144. The direct effect on firms is that they will incur administrative costs associated with the monitoring of customers to detect potential financial difficulty and take steps to help customers address that potential difficulty. Most firms that we surveyed indicated that they already have in place procedures to identify borrowers at risk of default. Therefore the likely additional costs of that assessment will be low.

145. We expect that as a result of the intervention some borrowers will avoid financial difficulty. This will lead to lower costs for firms associated with events associated with financial difficulty such as late payment, exceeding credit limit and recovering debt. It will also lower revenues from fees associated with such events. Firms will also receive lower interest revenue as a result of balances that are repaid faster and on time, but will accordingly have lower outstanding lending. Firms will benefit from a lower probability of customer default and so lower rates of charge off and lower cost of debt collection.

146. Currently firms may be deterred from intervening prior to the borrower entering an arrears state, even if it would be profitable for the firm to intervene, as the customer is still meeting their contractual requirements. For these borrowers the cost of lower interest payments foregone by the lender would be more than offset by the gains from lowering the cost of default. For other borrowers there will be net costs for the firms from early intervention.

147. In principle the lower profitability of some accounts as a result of the intervention could lead firms to change their lending decisions to reflect the change in expected future profitability of borrowers. We note that those targeted for early intervention are likely to be a small proportion of all borrowers which would limit the impact of changes in the profitability of that group on lending decisions. We also note that firms are currently obliged under CONC rules to base their lending decisions on a reasonable schedule of affordable repayments. So lending should not be conditional on the expectation of interest or charges that would accrue in the event of customer arrears, default or missed payments. Therefore we consider that, if firms are basing their lending decisions on our CONC rules, the scale of any effect of lending decisions is unlikely to be material.

148. Several firms have indicated that lost revenue arising from the reduction in lending to very high risk customers is offset by the reduction in bad debt and charge off, as well as having a positive effect on firms' reputation.

149. Firms expressed a view that "false positives" where the customer is not experiencing financial difficulties would significantly increase overheads and may lead to deterioration in customer satisfaction. However, this also means that firms will have an incentive to make the process as smooth as possible in order to avoid customer dissatisfaction.

150. Overall, the scale of the costs for early intervention depends on the profile of targeted borrowers, and firms' judgments on how many any which borrowers to contact.

Costs to the FCA

151. The cost to the FCA resulting from this proposal is the opportunity cost of FCA resource being employed to supervise and enforce the rule. Otherwise this resource could be employed elsewhere.

Conclusion

152. Overall we conclude that the proposed early identification of borrowers at risk of financial difficulty will be net beneficial for borrowers. Firms have information that allows them to predict when customers are at risk of financial difficulty and take appropriate steps at a point where borrowers may not themselves appreciate or recognise their position.

153. Borrowers will benefit from savings in charges and interest made as a result of avoiding arrears. The benefit will be proportional to the number of cardholders that avoid financial difficulty as a result of the intervention. The total costs of arrears are estimated to be potentially £140 million, of which 54% would be fees and 46% would be interest. However, what proportion of these savings are realised depends in part on how successful firms are in identifying the accountholders in a state of pre-arrears. Our findings suggest that if firms were able to identify 10% of these accounts and intervene to prevent arrears, savings would be approximately £14 million, although if they were able to identify and intervene on 50% of accounts the savings would be £70 million. Borrowers will also benefit from not experiencing personal distress due to being in arrears. Moreover, some customers will benefit from avoiding the withdrawal of promotional rates on their credit cards, such as 0% interest rates, and the consequences of default.

154. The system costs faced by lenders to identify those at risk of arrears are reported to be low, as many lenders already have such systems in place. As such we believe, based on the responses to the firms' survey, that the administrative costs to lenders of contacting borrowers at risk of arrears will also be low. Savings in charges and interest realised by customers will mean lower revenue for firms but also lower administrative costs associated with managing customers in financial difficulty and lower losses from default.

155. The scale of the overall costs will depend on the profile of targeted borrowers, and firms' judgments on how many any which borrowers to contact.

156. Overall we believe that the costs to both firms and customers are proportionate to the benefits of early engagement with borrowers at risk of financial difficulty.

Analytical Approach

Persistent Debt

Estimates of interest savings

157. Although there is significant uncertainty surrounding the interest savings from the proposed persistent debt rules we report we estimate that the total cost savings are expected to be within the range £3.0 billion to £13.0 billion. These benefits are estimated on the basis of savings[56] accruing over the period January 2018 to December 2030.[57] The benefits are expected to peak at £310 million per year in the lower case scenario and at £1.3 billion per year in the upper case scenario.

Method

158. To estimate the impact of the proposed rules on the credit card accounts identified as being in persistent debt, we use the account level submission collected by the FCA for the credit card

56 The estimates of the interest savings are reported on an undiscounted basis. By undiscounted, we mean that the savings have not been reduced to their present value.

57 In projecting the benefits over this period, we have assumed that the policy would not produce any interest savings before January 2018, and any benefits from the interventions at this stage would accrue after this point. We have chosen to cap our estimate of the cost savings at 2030. In part this is because we do not project any new flow out beyond this point. Furthermore, given the assumed 3 and 4 year terms on the repayment plan, the majority of the costs savings beyond this point result from the accountholder on the counterfactual repayment schedule adhering to minimum repayments. At this stage, the reduced balance implies minimum payments which are likely to be much lower and more affordable. Therefore, it is not clear that such a borrower would continue to make minimum payments, and assuming they do is likely to overstate the potential cost savings. Furthermore, we are aware that projections further into the future are less reliable due to economic and market conditions that will occur over time.

market study. Our sample comprises account-level information for the period January 2012 to January 2015 [58]. We assume that information from this period is a reasonable estimate of the likely situation at the time that the rules would come into force.

159. An accountholder is defined as being in persistent debt if their cost of borrowing as measured as the ratio of the fees and interest paid over the period to repayment of principal (i.e. total repayments less fees and charges), is greater than 1. The rule also requires that over the previous 18 months the monthly closing balance has permanently been above £200.[59] For the purposes of modelling the impact we have excluded accounts more than one month in arrears but in practice customers in this position may be subject to parts of the proposed intervention depending on whether they are being treated equally or more favourably under other rules (e.g. being shown forbearance under CONC 7.3.4R).

160. The cost of borrowing (or cost ratio) is calculated as:

$$\textit{Cost of Borrowing Ratio} = \frac{(\sum_{t=1}^{n} \textit{Total Cost (Fees and Interest)})_t}{(\sum_{t=1}^{n} \textit{(Repayments – Total Cost)})_t}$$

161. The proposed policy for identifying and dealing with accounts in a persistent debt state is a two staged approach. At stage:

- One: The firm applies the persistent debt definition and then assesses using the cost of borrowing rule whether the account is in a state of persistent debt. Interventions at this point are intended as a prompt to consumers to change their repayment behaviour if they can afford to do so. Accounts which are found to be in persistent debt at this point are then reassessed 18 months later as part of the stage two.

- Two: If the account is still found to be in a persistent debt state, then a second set of interventions are introduced, which require firms to help consumers repay their balance more quickly.

162. To obtain estimates for the number of accounts in persistent debt we first differentiate between those accounts which form part of the:

- Existing stock of accounts in persistent debt, which were identified as being in this state at both June 2013 and December 2014.

- New monthly flow of accounts into persistent debt from January 2015 onwards. For the new flow of accounts in persistent debt at January 2015, we identified those accounts which were not in persistent debt in June 2013, but first entered persistent debt in July 2014, and were also in a persistent debt state in January 2015.

163. It is important to recognise that accounts in persistent debt do not form a homogenous group, but rather experience varying degrees of detriment. We sought to capture this effect by segmenting the accounts in persistent debt – both stock and flow – by the severity of

58 To model the persistent debt impacts, we extracted a random sample of customer accounts which were open in June 2013. We then estimated the number of accounts in persistent debt in June 2013, using account data over the period January 2012 to June 2013. We repeated this process, to calculate the number of accounts in persistent debt each month, sequentially to January 2015.

59 This method has the advantage over other approaches in that it gives us a figure in pounds for the cost in interest and charges per £1 of principal repaid over the period.

their state. We differentiate between three groups of accountholders in persistent debt.[60] Accountholders who are in group:

1. Are likely to respond to communications at 18 month and so exit persistent debt before the assessment at 36 months.

2. Are likely to agree a repayment schedule sufficient to repay the current balance within a reasonable period.

3. Are likely to have affordability difficulties and thus require forbearance in order to repay their balance within a reasonable period.

164. For each type of accountholder we also distinguish between low balance accounts – less than £5,000 – and high balance accounts – £5,000 or more. For each of these 12 accountholder types we calculate the average balance and the average interest rate, and then build specific repayment schedules for each scenario.

165. We estimate the cost savings from the proposed rules by comparing the expected interest costs which the accountholder would have incurred had they continued to repay using a statutory minimum repayment schedule, to the interest costs accruing on an alternative repayment schedule which reflects the package of proposals. For each accountholder type we calculate the difference in the interest costs incurred on the repayment plan to the counterfactual based on the minimum payment rule. These estimates are then scaled by the number of accounts for each account holder type, and then aggregated to produce a market-wide estimate of the benefits.

166. Our assumed counterfactual, i.e. that absent intervention cardholders would make statutory minimum repayments, may not represent an exact picture of what would happen in the absence of the intervention.[61] [62] This may over or underestimate the actual repayments made for a number of reasons.

167. First, absent intervention some cardholders would make higher repayments and so would have exited persistent debt in any case. In addition, for some accounts the contractual minimum repayment may be higher than the statutory one. For these accounts the amount of interest they would pay under the counterfactual is overstated.

168. We note that, amongst accounts in persistent debt, contractual minimum repayments are greater than modelled minimum repayments for 12% of accounts and lower for 77% of accounts.

169. Second, for some legacy accounts the contractual minimum repayment will be lower than the statutory one.[63] In addition, there is a significant proportion, 38%, of accounts in persistent debt where missed payments occur. Missed payments incur charges and reduce the amount of the balance repaid. For both of these reasons actual repayments may be lower than in the modelled counterfactual.

60 Accounts are segmented on the basis of their cost ratio and whether they have missed payments or not over the previous 18 months. Accounts in group 1 have a cost ratio less than or equal to 1.5 and have not missed any payments. Accounts in groups 2 and 3 both have cost ratios more than 1.5. Where accounts in group 2 have missed at most 1 payment, while accounts in group 3 have missed more than 1 payment.

61 Statutory minimum repayment is equal to interest plus fees and charges plus 1% of the outstanding balance.

62 Our estimates of the cost savings from the proposed rules only take account of the expected interest savings. At present, no allowance is made for any fees and charges which accountholders might be expected to incur in the future. While this is a simplifying assumption and will results in an underestimation of the cost saving, an analysis of costs suggest that for accountholder in persistent debt the fees incurred on an account are typically much lower than is the case for other credit card users.

63 New statutory rules for minimum repayments were introduced by the Department for Business, Innovation & Skills (BIS) in 2010.

Constructing a repayment plan and counterfactual scenario

170. We estimate the interest savings arising from the proposed rules, and then compare to the appropriate counterfactual.

171. Given the uncertainty surrounding the cost savings from the proposed intervention we focus only on the current upper and lower limit estimates. Dealing with the upper limit scenario first, we make the following assumptions regarding how the repayment schedules are constructed:

- Accounts that exit persistent debt before the 36 month assessment point are assumed to increase their repayments between the assessments that take place at 18 and 36 months, such that their cost ratio falls below 1, producing interest savings. As a result of this faster repayment, these accounts will have a lower initial balance at the 36 month intervention point, resulting in future cost savings.

- Accounts where the cardholder is expected to agree to a fixed repayment schedule will repay the original debt in 3 years (4 years where original debt is £5,000 or more). However, as the accountholder can continue to spend on the account, we assume that this faster repayment will be offset by some additional borrowing. We assume that half the value of the additional repayments on the schedule relative to the counterfactual will be offset by further spending on the card. The required repayment on this new borrowing is fixed at a level which ensures that the cost ratio associated with this additional spending remains below 1.

- Accounts where the cardholders are expected to find it difficult to afford increased repayments. These accounts are placed on a repayment schedule but are given forbearance. We assume that the repayment will be determined by the statutory minimum repayment applied to the account balance in the first month of the repayment schedule. All subsequent repayments will be fixed at this level for the remainder of the term. To alleviate any affordability difficulties arising from the higher level of repayments we assume the accountholder receives interest forbearance, which enables them to pay down their initial balance within 3-4 years.[64] We assume that further borrowing is suspended while the account is on such a repayment schedule.

172. By contrast, our lower bound scenario assumes that the only group who engage with the process and benefit from interest savings are those who experience affordability problems and receive forbearance, i.e. group 3. This group continues to receive interest forbearance as in the upper bound scenario. But now we assume that they offset half of the additional repayments they make as part of the repayment schedule with spending elsewhere. We assume for the purposes of the lower bound that accountholders in groups 1 and 2 do not engage or engage in offsetting expenditure so their interest savings are effectively zero.

Results: Number of accounts impacted

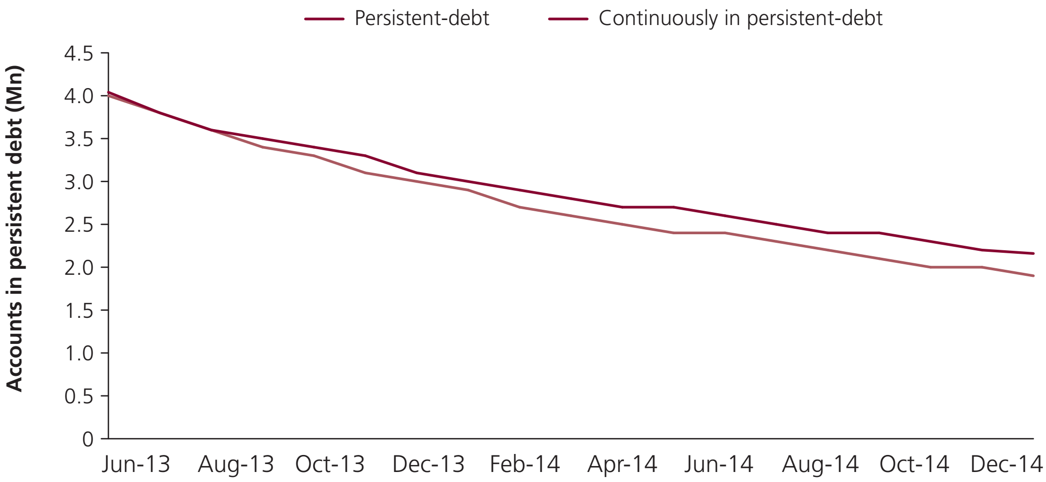
173. We assume that stage 1 of the persistent debt policy will be introduced not before January 2018 with stage 2 being introduced 18 months afterwards. However, to examine what the potential impact of the persistent debt rule may be we apply the rules retrospectively to our sample of accounts. Where the stage 1 of the intervention is estimated as if it was introduced in June 2013 and stage 2 of the intervention is introduced in December 2014.

174. We estimate that a stock of approximately 4 million accounts is caught by the persistent debt definition at June 2013. Of these accounts, 2.2 million remain in the state of persistent debt in

64 Firms are required to show forbearance to enable repayment in 3-4 years. Given the flexibility that firms have in applying forbearance we use forbearance to allow repayment in 4 years as part of the lower bound of expected interest savings and 3 years as part of the upper bound.

December 2014.[65] Figure 12 illustrates how the number of accounts in persistent debt would have evolved over this period. While the number of accounts in persistent debt in December 2013 is approximately half of what it was in June 2013, it is also clear that approximately 90% of these accounts have remained continuously in that state over the entire period. This may be a sign that there are a larger number of accounts that are in a cycle of borrowing which they cannot afford to pay down.

Figure 12: Numbers of accounts in persistent debt (June 2013 to December 2014)



Source: FCA analysis of account-level submissions

175. The 2.2 million accounts that are in the existing stock, that remain in the state of persistent debt in December 2014 have a total outstanding debt of £7.8 billion (or £3,624 per account) – see Table 3. Of these accounts, 11% were found to be in a position that a relatively small increase in repayments would lead the account to exit persistent debt before 36 months and data obtained as part of our firm survey suggests this is a reasonable estimate of customer response rates. 63% would agree to a repayment schedule and 23% are accounts with affordability difficulties

176. The next step is to estimate the new flow of accounts which enter persistent debt each month. To calculate the new monthly flow, we identify those accounts that were not in persistent debt in June 2013 and, therefore, not part of the original flow, but first entered persistent debt in July 2013, and were in a persistent debt state 18 months later in January 2015.

177. We estimate that the new monthly flow at January 2015 comprises approximately 50,000 accounts, with outstanding debt of £172 million (or £3,431 per account) – see Table 3. Of these, 16% could exit persistent debt with a relatively small increase in repayment and so are expected to exit persistent debt before 36 months based on the data we received on customer response rates. 52% are in a position to agree to an affordable repayment schedule and 32% are in a position such that only a repayment schedule with interest rate forbearance is affordable.

65 To calculate the number of accounts in persistent debt, we took a random sample of customers with a credit card account(s) which were open in June 2013, and estimated that approximately 7% and 3.7% of these accounts were in persistent debt at June 2013 and December 2014, respectively. We estimated using data from a CRA that there were approximately 58 million credit card accounts registered as open in June 2013. Scaling by our estimates of the proportion of accounts in persistent debt, we estimate that approximately 4 million and 2.2 million accounts are in persistent at each intervention point respectively.

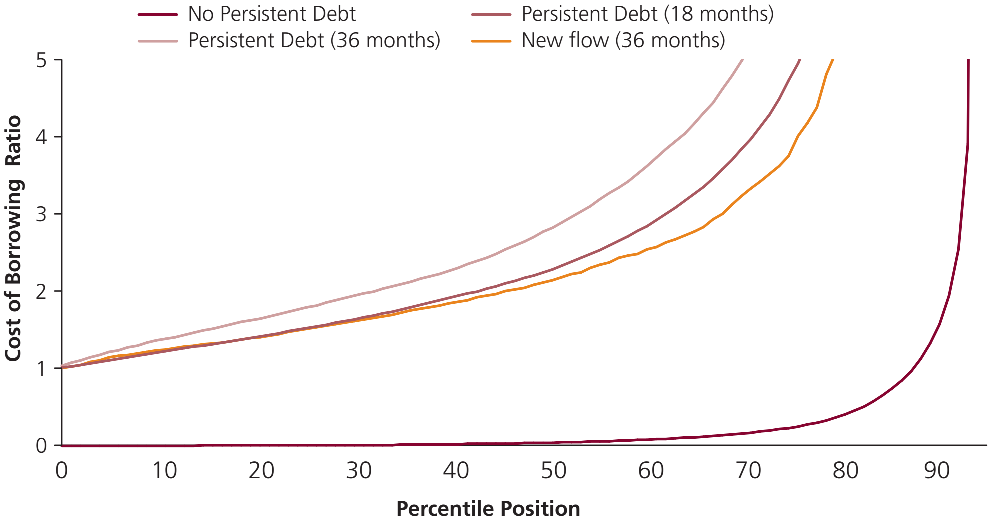
Table 3: Number of accounts in persistent debt by account-type

	All accounts in Persistent Debt	Accounts that exit Persistent Debt before 36 months	Accounts on repayment schedule	Accounts with affordability difficulties
A. Existing stock				
Number of accounts	2,162,000	240,000	1,352,000	571,000
Initial Debt (£Billion)	7.8	0.8	5.2	1.9
Average debt (£)	3,624	3,403	3,824	3,243
A. New monthly flow				
Number of accounts	50,000	8,000	26,000	16,000
Initial Debt (£Million)	172	28	92	52
Average debt (£)	3,431	3,441	3,523	3,274

178. Compared to the stock of accounts, the new flow of accounts in persistent debt has slightly smaller balances. Proportionally more flow accounts would require forbearance, but more are also likely to exit persistent debt at phase I.

179. To allow a comparison of the cost ratios for accounts in the various stages of persistent debt, Figure 13 illustrates how the distribution varies for these groups.

Figure 13: Cost of borrowing ratio*



* To compare the distributions for different groups we rank the cost ratio for each group from highest to lowest and then report the percentiles

Source: FCA analysis of account-level submissions

180. It is clear that accounts in the existing stock which are in persistent debt at 36 months have on average the highest cost ratio, with a median of 2.7. This compares with a median of 2.2 for those accounts that were in persistent debt at 18 months. By contrast, the median cost ratio for accounts not in persistent debt the cost ratio is 0.03.

Results: Estimate of expected interest savings

181. To estimate the cost savings we apply the relevant package of proposals to the:

- existing stock of accounts in persistent debt
- new month flow accounts in persistent debt, and then projecting these accounts forward into the future to produce an estimate of the cumulative savings

182. We then aggregate these estimates together to produce a market-wide impact.

183. Next we produce estimates for the lower and upper bounds. We first show how the upper bound estimate is constructed and then replicate this method for the lower bound estimate.

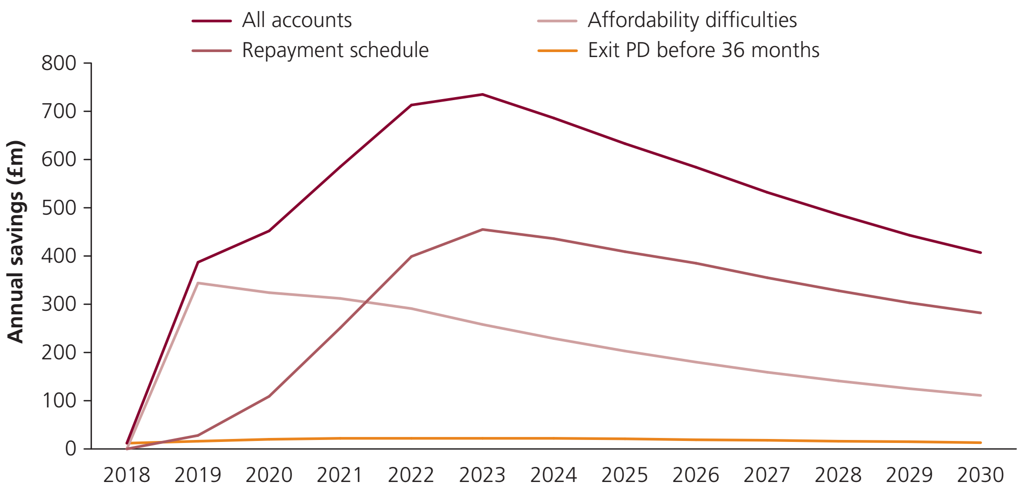
Upper bound estimate of the cost saving

Existing Stock

184. As a result of the interventions and the decision to move the accounts onto the alternative repayment schedule, we estimate that the cost saving arising from faster repayment is £6.7 billion (approximately £3,079 per account). Figure 14 shows how this cost savings break down annually – peaking at approximately £700 million.

Figure 14: Interest savings for the existing stock*

Annual savings (£ Million)*



* Note: Total future savings extend beyond 2030

Source: FCA analysis of account-level submissions

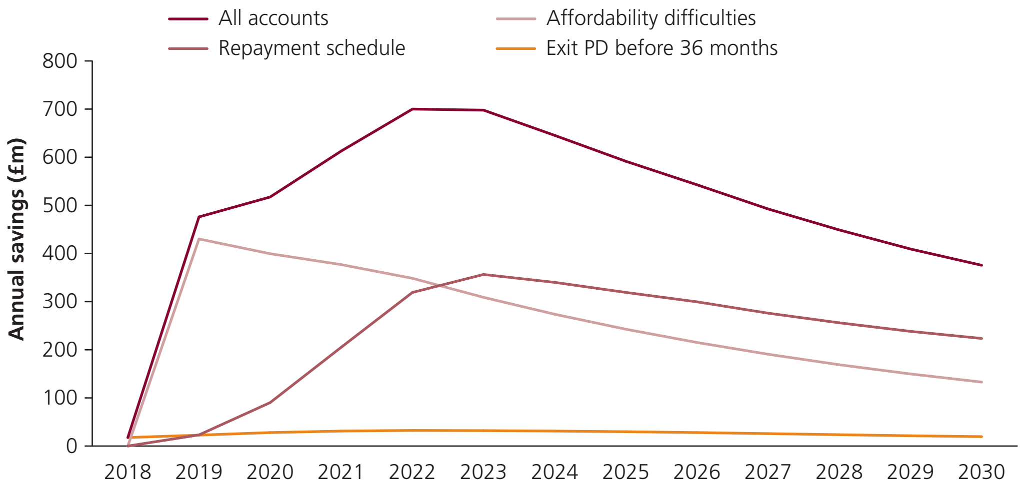
Table 4: Total and average savings for existing stock (£m)

	All accounts in Persistent Debt	Accounts that exit Persistent Debt before 36 months	Accounts on repayment schedule	Accounts with affordability difficulties
Number of accounts	2,162,000	240,000	1,352,000	571,000
Total savings (£Billion)	6.66	0.2	3.74	2.68
Average savings (£)	3,079	993	2,768	4,691

Flow of new accounts

185. We estimate that the cost saving for this month of new flow will be £147 million (£2,937 per account). Figure 15 show how cost savings accrue annually.

Figure 15: Interest savings for new monthly flow*
Annual savings: (£m)*



* Note: Total future savings extend beyond 2030

Source: FCA analysis of account-level submissions

Table 5: Total and average savings for new monthly flow (£m)

	All accounts in Persistent Debt	Accounts that exit Persistent Debt before 36 months	Accounts on repayment schedule	Accounts with affordability difficulties
Number of accounts	50,000	8,000	26,000	16,000
Total savings (£ Million)	147	8	66	73
Average savings (£)	2,937	965	2,541	4,580

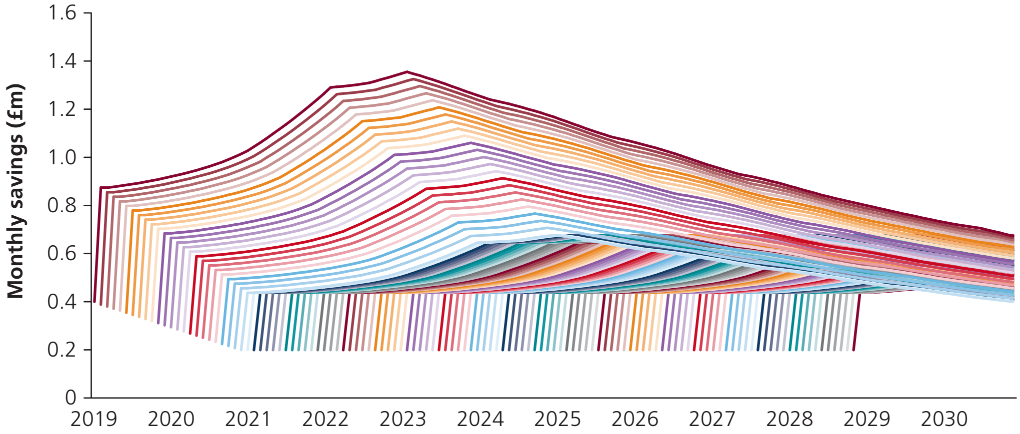
186. The next step is to forecast the future monthly flows of accounts into persistent debt state. Following the introduction of the persistent debt rules and greater awareness of the consequences of being in persistent debt, it seems reasonable to assume that both accountholders and firms would react to the new rules in such a way that reduces the prevalence of persistent debt in the future.

187. However, predicting the expected attrition rate is challenging, because while we would expect the incidence of persistent credit card debt to fall, the speed at which it declines or the limit of the decline are uncertain. Therefore, we approximate this using some simplifying but reasonable assumptions.

188. We assume that the number of the new accounts that enter persistent debt state will decline linearly over 2 years to 50% of the original number of accounts, i.e. 25,000 accounts, at which point the flow remains constant. We assume that the characteristics of the portfolio of credit card debt in terms of distribution of accounts between the different types of accountholders and average outstanding balances remain the same. We forecast monthly flows out for 10 years.

189. The next step is to aggregate the new monthly flow over time, to produce an estimate of the cumulative interest savings. Figure 16 shows the flow of monthly savings over time. It is clear that the monthly flow declines initially, reflecting the attrition assumption over the first 2 years, but then remains constant.

Figure 16: Cumulative monthly flow of accounts in persistent debt (2019-2030) [66]



* Note: Total future savings extend beyond 2030

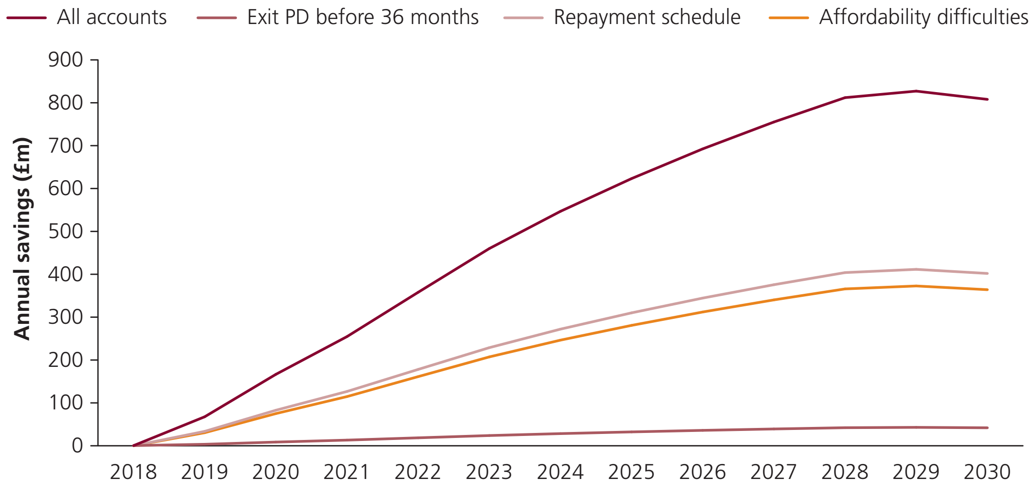
Source: FCA analysis of account-level submissions

190. We estimate that there are 3.3 million accounts in the cumulative flow, which accounts for cost saving of £6.4 billion (£1,931 per account). Figure 17 shows that these cost savings peak at £830 million annually.

191. The total interest savings for the new flow are calculated by aggregating all the interest savings relating to a particular month. These monthly estimates are then aggregated to an annual level.

66 Each line in Figure 16 represents the interest savings accruing over time to a particular month of new flow. To calculate the total interest saving at a particular point in time, we sum across all the monthly flows with interest savings in that month. These monthly estimates can then be aggregated into produce annual estimates. In 2019, the average monthly saving for the January-2019 new flow is approximately £0.9 million. This produces an annual interest saving from this month of new flow of approximately £10.8 million – as shown in Figure 16 above. To produce an annual estimate of all the total interest savings in 2019, we need to aggregate across all monthly savings for each of 12 months of new flow. Together this produces total savings of £67 million – as shown in Figure 17 below.

Figure 17: Interest savings for cumulative monthly flow of accounts (2019-2030)*
Annual savings: (£m)*



* Note: Total future savings extend beyond 2030

Source: FCA analysis of account-level submissions

Table 6: Total and average savings for cumulative monthly flow of accounts (£m)

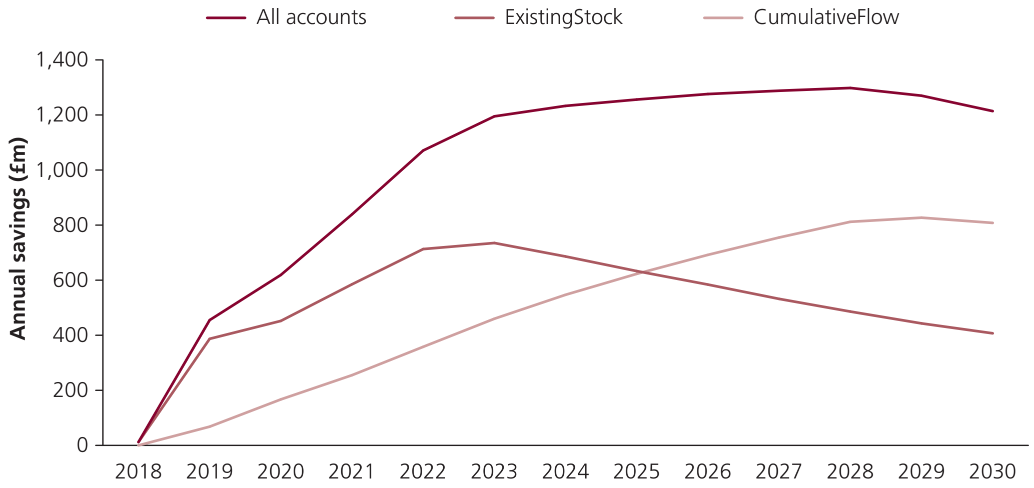
	All accounts in Persistent Debt	Accounts that exit Persistent Debt before 36 months	Accounts on repayment schedule	Accounts with affordability difficulties
Number of accounts	3,300,000	528,000	1,722,000	1,050,000
Total savings (£Billion)	6.37	0.33	3.17	2.87
Average savings (£)	1,931	627	1,840	2,735

Summing the existing stock and new flow

192. To estimate the total cost saving from the persistent debt rules modelled by the upper bound scenario, we aggregate our estimate of the cost savings from the existing stock and ongoing flow.

193. The impact of the upper bond cost saving scenario is summarised in Figure 18. We estimate that 5.5 million accounts would have achieved cost savings as a result of the intervention, with the total cost savings estimated to be £13.0 billion – comprised of £6.6 billion from the existing stock and £6.4 billion for the cumulative flow. Considering the annual savings, we observe that the estimates of the cost savings peak at approximately £1.3 billion a year. In the early part of the period, the cost savings from the stock dominates, and in the later period the cost savings from the flow.

Figure 18: Estimate of the upper-bound cost savings*
Annual savings: (£m)*



* Note: Total future savings extend beyond 2030
Source: FCA analysis of account-level submissions

Table 7: Total and average savings for upper-bound scenario

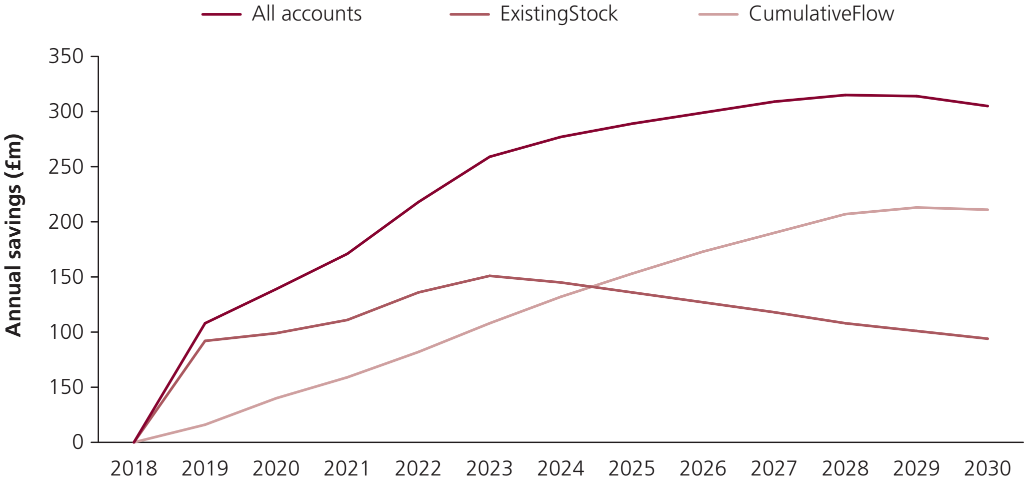
	All accounts in Persistent Debt	Existing stock	Cumulative monthly flow
Number of accounts	5,461,000	2,161,000	3,300,000
Total savings (£Billion)	13.03	6.66	6.37
Average savings (£)	2,385	3,079	1,931

Lower bound estimate of the cost saving

194. To calculate the lower bound cost estimate, we used the same method as shown above in the case of the upper bound scenario. But in this case we assume that that the only group who engage with the process and benefit from interest savings are those who experience affordability problems and receive forbearance.

195. The estimated lower-bound cost savings are summarised in Figure 19. The total cost savings are estimated to be £3.0 billion – comprised of £1.4 billion for the existing stock and £1.6 billion for the cumulative flow. Considering the annual savings reported in Figure 19, we observe that the annual estimates of the cost saving peak at approximately £310 million.

Figure 19: Estimate of the lower-bound cost savings*
Annual savings: (£m)*



* Note: Total future savings extend beyond 2030
Source: FCA analysis of account-level submissions

Table 8: Total and average savings for lower-bound scenario

	All accounts in Persistent Debt	Existing stock	Cumulative monthly flow
Number of accounts	5,461,000	2,161,000	3,300,000
Total savings (£ Billion)	3.00	1.42	1.58
Average savings (£)	550	656	480

Earlier Intervention

196. The early intervention proposal requires credit card firms to monitor an accountholder's repayment behaviour and other relevant information for signs of actual or potential financial difficulty. Where identified, firms are then required to take appropriate action.

197. To model the potential impacts of the proposals, we track a random sample of accounts over the period January to December 2014.[67] We identify all those accounts which were up-to-date with payments their repayments in January and then monitor their arrears status over the rest of the year. Although the length of time an account would spend in pre-arrears state is unclear, we assume up to 12 months is a reasonably accurate forecast period where firms would be able to identify accounts at risk of financial difficulty.

198. The goal was to identify those accounts which start the year up-to-date with payments but subsequently experience arrears. We then estimate the average costs the account holder incurs from falling into arrears. These costs represent the potential benefits from an earlier intervention remedy which is designed to target accounts at a pre-arrears stage, reducing the likelihood and severity of financial difficulty.

199. For accounts which experience arrears, we calculate their:

67 To model the impacts of the early intervention proposals we extracted a random sample of customer accounts which were open in January 2014. We then identified that more than 85% of these accounts were up-to-date. Using data from a CRA, we estimated that there were approximately 56 million credit card accounts registered as open in January 2014, and therefore estimated that the number of accounts which were up-to-date with payments was approximately 48 million.

- worst arrears status
- duration or length of time they spent in arrears
- direct costs: Estimated as the additional fees and interest incurred from being in arrears.
- indirect costs: Estimated as the increased risk of default and the expected increase in the cost of funding from having been in arrears.

Direct Costs

200. Having estimated these variables at an individual account level, we calculate the average impacts, aggregating accounts on the basis of their worst arrears status.[68] The results of the early intervention analysis are reported in Table 8.

201. From Table 8, we estimate that 910,000 (approximately 2%) accounts – which are up-to-date with payments in January-2014 – experience arrears of 2 or more months at some point in the subsequent 12 months. We observe that the more severe the arrears state and the longer the length of time an account experiences arrears, the greater the costs of arrears. For instance, accounts where their worst state of arrears is:

- not having been more than to 2 months in arrears, have on average been in arrears for 3.8 months during the years, and experience an average cost of £62
- charged-off[69], have on average been in arrears for 6.8 months during the year, and experience an average cost of £117.

202. We estimate that the average direct cost from experiencing arrears in the initial 12 month period is £94 per account. Scaled by the number of accounts which experience arrears gives a total industry cost saving of £86 million. However, the cost of arrears extends beyond the initial assessment period. With 40% of those accounts which experience arrears in 2014, still 2 or more months in arrears at the end of the period. We estimate that these accounts would incur an additional average cost of £150. This equates to a further potential cost saving of £55 million.70

203. Therefore, we estimate a total potential cost saving from avoiding arrears is £141 million, of which 54% arises from fees and 46% comprises interest savings.[71]

204. The actual proportion of these savings which are realised depends in part on how successful firms are in identifying accounts in a pre-arrears state, and how responsive customers are in acting on the intervention. If firms are able to identify:

68 By the worst arrears state we refer to how many cycles overdue an account has been. For instance, an account with an arrears status of 2 months, has been at most 2 months overdue, even though they may have missed more than 2 payments over the course of 2014. Accounts which are more than 90 days overdue are at risk of being charged-off, although the actual charge-off policy varies across firms.

69 Charge-off occurs where firms a firm takes the view that a debt is unlikely to be collected. Once an account is more than 90 days overdue it is at risk of being charged off. However, we observed that a significant proportion of the accounts in our dataset which were charged-off – approximately 41% – had not previously been in serious arrears. Conversations with the industry suggested that these accounts had been charged off because of death and not because of financial difficulties. For this reason we excluded these accounts from our charge-off definition.

70 We approximate the additional costs for those accounts that are still in arrears beyond 2014, by imputing estimates for those accounts in our early intervention sample who were not up-to-date with payments in January 2014. For those accounts we calculate their average cost of arrears over the remainder of the year. We then scale these costs estimates by the number of accounts still in arrears in December 2014.

71 The cost savings are calculated only from fees and interest related to arrears. No account has been made for cost savings which may arise from charged-off accounts – such as debt collection. In 2014, we estimate that 190,000 accounts were charged-off due to repayment problems, where the average account balance was £1,578.

- 10% of those accounts then the expected cost saving may be £14 million;
- 50% of those accounts then the expected cost saving may be £70 million.

205. Therefore, we propose a range for the cost savings from the early intervention remedy of £14 million to £70 million.

206. Accountholders impacted by our definition of arrears – of 2 or more months – are unlikely to experience arrears by mistake or accident. Therefore, by observing their usage and repayment behaviour, firm should have important information which will help them to successfully identify a significant proportion of these accountholders. Furthermore, given that the majority of the cost savings arise from those accountholders who experience the severest forms of arrears, if firms were only able to identify these accountholders, then significant savings could still be accrued.

Indirect costs

207. Accountholders who miss payments will also experience an indirect cost from arrears in terms of their reduced credit-worthiness. The immediate impact will be reflected in a lower credit score, which reflects both a higher risk of default and being charged-off, and an increased cost of borrowing.

208. To calculate the increased risk of default we calculate the average credit scores for accountholders in the different states of arrears. [72] We then translate these credit scores into the expected probability of default. Our analysis suggests that accounts that are 2 months (more than 3 months) in arrears have a 13% (37%) probability of default, respectively. By comparison, the average credit score for accounts that are up-to-date with payments indicates a probability of default of approximately 1%.

209. We proxy the impact of arrears and reduced credit worthiness on the cost of credit. We compare the average interest rate for accounts in a particular arrears state to the average rate on accounts that are up-to-date with payments and calculate the difference. We estimate that accounts that are 2 months (more than 3 months) have a cost of credit which is approximately 5.5% (8.3%) higher than those accounts that do not experience arrears.

Table 8: Early intervention: Cost of arrears (January to December 2014)*

					Average Direct Costs (£)			Average Indirect costs	
Worst Arrears State	# Accounts (000s)	Avg Duration (Months)	Avg Account Balance (£)	APR (%)	Fees (£)	Interest (£)	Total (£)	P (Default)	d Cost of Credit
2 months	380	3.8	1,837	23.4	51	12	62	13%	5.5%
3 months	140	5.0	2,141	26.0	66	23	88	37%	8.1%
> 3 months	200	6.5	2,306	25.8	84	51	136	37%	8.3%
Charged-Off	190	6.8	1,677	26.5	87	30	117	-	-
All accounts	910	5.2	1,955	25.0	68	26	94	21%	6.8%

* Interest is calculated by applying the monthly APR on the card to the outstanding arrears balance. Interest is then summed over the months where the account has been in arrears. Fees are calculated as the sum of the monthly late payment and return payment fees.

72 To calculate the probability of default we use credit scores and a lookup table provided by a CRA. However these estimates only indicative of the probability of default. As the customer credit scores used in this analysis were not contemporaneously collected at the point the account experiences arrears, but some months afterwards.

Annex 3: Compatibility statement

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by section 138I(2)(d) of the FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under section 1B(1) of the FSMA, so far as reasonably possible, to act in a way that is compatible with its strategic objective and advances one or more of its operational objectives; and (b) its general duty under section 1B(5)(a) of the FSMA to have regard to the regulatory principles in section 3B of the FSMA. The FCA is also required by section 138K(2) of the FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (section 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

4. This Annex explains how the FCA has had regard to the recommendations made by the Treasury under section 1JA of the FSMA about aspects of the economic policy of Her Majesty's Government to which the FCA should have regard in connection with its general duties.

5. This Annex refers to our assessment of the equality and diversity implications of these proposals.

6. Under the Legislative and Regulatory Reform Act 2006 (LRRA), the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions; and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

Equality and diversity

7. We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.

8. The outcome of the assessment in this case is stated in paragraph 1.46 of the CP.

Expected effect on mutual societies

9. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies. The proposed rules would apply to any mutual societies that offer credit cards in the same way as other, non-mutual, firms and we would not expect them to present any advantage or disadvantage to a firm on the basis of their mutual status.

The FCA's objectives and regulatory principles

10. We consider the proposals in this CP are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because we expect them to address a significant market failure in the credit card market to deliver a better outcome for affected consumers. For the purposes of the FCA's strategic objective, 'relevant markets' are defined by section 1F of the FSMA.

11. The proposals set out in this CP are primarily intended to advance the FCA's operational objective of achieving an appropriate degree of protection for consumers.

12. The intention of our proposals in relation to persistent credit card debt is to tackle a market failure whereby a significant number (albeit a minority) of customers carry a credit card balance for a long period of time without significantly paying it down. This can lead to very high debt servicing costs and may be caused by customers either deliberately or unintentionally repaying slowly, or simply being unable to afford to repay more quickly. Firms do not have an incentive to intervene since these customers are profitable and, provided they do not fall into arrears, will continue to be so for an extended period of time.

13. We are aiming to align customers' and firms' incentives to encourage customers to repay more quickly where they can afford to do so, and to deliver forbearance where customers are struggling to repay their debt.

14. Our proposals on earlier intervention are intended to encourage credit card firms to identify customers are risk of potential financial difficulties before they crystalise. We propose to require credit card firms to use relevant data available to them to identify such customers and take appropriate steps.

15. Section 1B (4) of the FSMA requires us, so far as is compatible with acting in a way which advances the consumer protection objective, to discharge our functions in a way which promotes effective competition in the interest of consumers.

16. We do not expect our proposals on persistent debt to undermine competition and, while they are not directly addressed at encouraging greater competition, they may nonetheless do so. This is because customers in persistent debt are profitable and at the 36 month point many may be more receptive to offers of balance transfer deals than they would otherwise have been. While a firm acquiring their custom would not be receiving interest income for the period of the promotional deal, such customers are likely to be attractive, as there is typically a balance transfer fee and some customers may not repay the full balance within the promotional period. A balance transfer deal is likely to be in customers' interests as it would likely see them repay their debt more quickly without having to increase monthly repayments (as they may have to do if they stayed with their current credit card firm). As a result, some firms may increasingly compete to attract customers in persistent debt through balance transfer deals. If this was the case, firms may respond by offering existing customers in persistent debt other inducements not to switch, such as offering a promotional interest rate period on their existing balance. This is also likely to be in customers' interests.

17. In relation to earlier intervention, the customers affected are not generally likely to be customers that firms are likely to compete for, as they will tend to be at an increased risk of developing financial difficulties. Our proposal is intended to achieve the appropriate level of consumer protection. As such, we do not consider it is likely that proposals in this area could have the effect of promoting competition.

Persistent credit card debt

Matters we must have regard to under the consumer protection objective

18. Below we explain how we have had regard to each of the eight matters listed in section 1C (2)(a)–(h) of the FSMA.

The differing degrees of risk involved in different kinds of investment or other transaction

19. We have taken this matter into account in bringing forward proposals on persistent credit card debt, recognising that the features of credit cards create a risk of persistent debt that does not necessarily exist in the same way in other credit products, in particular fixed-sum loans. It is possible for customers to sustain a credit card balance for a long period of time by making minimum repayments while paying significant interest charges, but not significantly reducing the balance.

The differing degrees of experience and expertise that different consumers may have

20. Our proposals in relation to persistent debt take this into account and it is reflected in the design of our proposed intervention. We recognise that customers in our persistent debt definition are likely to be in a diverse set of circumstances, and our proposals are intended to filter these customers in such a way that they receive the most appropriate intervention. For example, some customers who are intentionally or unintentionally repaying slowly, but could afford to repay more quickly, may change their behaviour in response to the prompts at 18 months or, if not, agree to an affordable schedule of repayment at 36 months. Customers in persistent debt who cannot afford to repay more quickly will be treated with forbearance and due consideration, which may include interest rate concessions to assist the customer to repay more quickly.

The needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose

21. We have explicitly recognised this in our proposals by requiring that firms inform customers in our persistent debt definition over 18 months that: they should repay more quickly if they can afford to; their repayment pattern is likely to lead to high debt servicing costs; and, if they do not repay more quickly, they will face stronger interventions in a further 18 months.

22. In addition, we propose that where a customer is continuing to repay in such a way that it appears likely they will remain in persistent debt at the 36 month point, firms must remind customers mid-way through the period in order to give them an opportunity to engage and agree to repay more quickly.

The general principle that consumers should take responsibility for their decisions

23. We have taken this principle into account when developing our proposals on persistent debt, and it has shaped the structure of our proposed intervention. For example, we are proposing that a customer would have to be in persistent debt for a period of 36 months before firms would be required to make stronger interventions. Interventions prior to 36 months would place the onus on customers to take responsibility for their decisions and repay more quickly if they could afford to do so.

24. We have decided that an easily accessible exception that would allow customers to opt out of the intervention, or parts of the intervention, would undermine the policy intention. In order to create a strong incentive for customers to engage, and for firms to effectively seek to elicit engagement, we propose that customers who do not engage with their credit firm at 36 months, or who confirm they can afford faster repayments but decline to make them, would have their ability to use the card suspended. This would give firms an incentive to intervene effectively since suspending use of customers' cards is likely to increase lost revenue from further spending. It also gives customers an incentive to engage and to agree to repay more quickly where affordable if they wish to avoid suspension of their card and the potential reporting of this to a CRA.

The general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate, having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question

25. Our proposal on persistent debt was developed with regard to this matter, which is intended to place incentives (and requirements) on firms to intervene when customers are in persistent debt. At present, firms have few incentives, and no requirements to do so, as these customers remain profitable. The risk to customers in this position is primarily that they are paying significant debt servicing costs which, where customers cannot afford to repay more quickly, may be reducing their ability to repay the debt any faster than through minimum or near minimum repayments.

The differing expectations that consumers may have in relation to different kinds of investment or other transaction

26. Our proposals take this matter into account through proposing a series of prompts and interventions that would be delivered to customers who, for reasons of inertia or misunderstanding of the nature of the credit card product, are sustaining a persistent level of debt without making significant reductions when they could afford to repay more quickly.

Any information which the consumer financial education body has provided to the FCA in the exercise of the consumer financial education function

27. This matter is not relevant to these proposals, as we have not been provided any relevant information by the consumer financial education body on this subject.

Any information which the scheme operator of the ombudsman scheme has provided to the FCA pursuant to section 232A

28. This matter is not relevant to these proposals, as we have not been provided any relevant information by the scheme operator pursuant to section 232A on this subject.

The FCA's regulatory principles

29. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in section 3B of the FSMA. Below, we explain how we have done this (except where the principle is the same as one of the principles we must have regard to under the consumer protection objective, in which case it is explained above).

The need to use our resources in the most efficient and economic way

30. We consider that the proposals are compatible with this principle, on the basis that we have identified that persistent debt is a significant issue facing a large number of customers and using FCA resources to design, consult, implement and supervise an intervention in this space is proportionate.

The principle that a burden or restriction should be proportionate to the benefits

31. We have considered this carefully when designing our proposed intervention. Where there are burdens or restrictions (for example, requiring firms to stop customers using their credit card or to show forbearance), they will only apply to sub-groups of customers who have been in persistent debt for a period of at least 18 months. The more significant burdens occur once a customer has been in persistent debt for two consecutive periods of 18 months. This will help to ensure that we target the groups of customers who are unequivocally carrying a credit card debt over a long period of time without making meaningful reductions in their balance. The burdens are proportionate to the benefits of consumers repaying more quickly, and potentially being offered an interest rate reduction to help them out of persistent debt.

32. These interventions are designed to align incentives for both customer and firm to avoid getting into persistent debt in the first place, but also to engage to agree the best route to tackle it where it develops. We have also taken the approach of proposing a high-level rule requiring firms to help affected customers repay their balance more quickly without setting rigid expectations on firms about how they will achieve this outcome.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

33. We have had regard to this principle in developing our proposals. While credit card transactions and interest payments contribute to GDP, and our proposals are (on face value) likely to lead to fewer transactions and lower interest payments by some customers, the net effect of this could be beneficial for sustainable growth.

34. Customers who repay more quickly, and therefore pay less in interest than they would otherwise have done, may spend the money they have saved over the medium term in the wider economy, thus contributing to economic growth. This is also true where customers in persistent debt who cannot afford to repay more quickly are given assistance to help them repay. The counterfactual for these customers sees them potentially spending a significant proportion of their disposable income on interest payments over a long period of time. Clearly, where customers are paying less in interest this implies forgone revenue for firms which would offset at least some of the potential growth as a result of customers having increased disposable income in the medium to long term. In addition, some customers may offset their increased repayments by spending more on the card. Ultimately, there are a range of potential effects depending on how firms and consumers behave over the longer term, but we do not believe our proposals are incompatible with this principle.

The responsibilities of senior management

35. We consider that this principle is not relevant to the persistent debt proposals, as it does not create or affect any responsibilities directly placed on senior management.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

36. Our proposal would apply to firms offering credit cards to consumers, regardless of the type of person carrying out that activity, but we do not expect it would present any particular difficulties for mutual societies or other kinds of business organisation engaged in this activity.

The desirability of publishing information relating to persons subject to requirements imposed under the FSMA, or requiring them to publish information

37. This principle is not relevant to these proposals, as they do not involve any requirements imposed under the FSMA, nor do we judge that there is a particular benefit in requiring them to publish information.

The principle that we should exercise of our functions as transparently as possible

38. We have had regard to this principle and ensured, where possible, that we have discussed the issues identified as part of the CCMS with relevant stakeholders, including the industry, trade bodies and consumer groups. We have shared our thinking on remedies insofar as was appropriate, and discussed with the industry their proposals for voluntary intervention.

39. In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by section 1B(5)(b) of the FSMA). The proposals are not relevant to this as they do not affect, either positively or negatively, the risk of financial crime.

Earlier intervention

Matters we must have regard to under the consumer protection objective

40. The proposals set out in this CP regarding earlier intervention by credit card firms primarily advance our operational objective of securing an appropriate degree of protection for consumers.

41. In formulating these proposals, we have considered the appropriate degree of protection for consumers in light of the matters set out in section 1C of the FSMA.

Differing degree of risk involved in different kinds of investment or other transaction

42. Our proposals are rooted in the principle that the extent and scope of monitoring, identification and action by credit card firms should be proportionate to the risks that individual customers may be in financial difficulties. In general, firms should consider the complexity of customer behaviour, variations in products and customer profiles when assessing the level of risk and deciding on the appropriate assessment process. Our existing rules require firms to monitor repayment records for signs of actual or potential financial difficulty but we believe it is necessary to go further in relation to credit cards. This is because the ability to vary spending and repayment behaviour is significantly different than on a personal loan, for example, and this behaviour in itself – among other data – may be a useful indicator for actual potential financial difficulty.

Differing degrees of experience and expertise that different consumers may face

43. Promotion of earlier intervention by credit card firms to identify, contact and take appropriate action where customers are at risk of financial difficulties should particularly enhance protection of sub-prime and vulnerable customers. The proposals should help to reduce cycles of financial difficulties, and promote the provision of information by firms to customers on the risks that may result from missed payments and sources of debt advice in order to encourage informed choices.

44. We expect that the proposals should also encourage and facilitate affordable borrowing, which offsets the risks that some customers may suffer from behavioural biases (such as 'present bias' or over-confidence) or lack financial sophistication.

The needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose

45. The proposals will require credit card firms to take appropriate action where customers are identified as being at risk of financial difficulties. Appropriate action may include the provision of information such as notifying the customer of the risk of escalating debt, additional interest or charges and of potential financial difficulties. We consider that this requirement will reduce risks of variation across credit card firms on whether to contact customers who are in potential financial difficulties.

The general principle that consumers should take responsibility for their decisions

46. Our proposals are intended to place greater responsibility on credit card firms to intervene earlier and take action where consumers are at risk of financial difficulties. In some circumstances the appropriate action will be to notify the customer of the risk of escalating debt, or provide details of debt advice bodies, steps which place responsibility for further action on consumers.

The general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate, having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question

47. Our proposals aim to enhance responsible lending by requiring firms to monitor for and identify customers in financial difficulties, which takes into account changes in circumstances that impact on the customer's ability to repay. Firms will have better data than the FCA on their customers, and will have incentives to identify and take effective action, since defaulting customers are expensive. Firms will therefore be in the best position to decide what steps are required and take clear, effective and appropriate action on customers at risk of financial difficulties.

The differing expectations that consumers may have in relation to different kinds of investment or other transaction

48. Proportionality is likely to be in line with customer expectations in that a consumer may anticipate greater monitoring according to the size of firm. For example, a more rigorous degree of monitoring and action, including customer contact, might be expected depending on whether the firm is monoline (offering one credit card service only) or a bank offering variations in products and with different customer profiles.

The FCA's regulatory principles

49. In preparing the proposals set out in this consultation, we have considered the regulatory principles set out in section 3B of the FSMA. We explain below how our proposals demonstrate such regard for each of the regulatory principles.

The need to use our resources in the most efficient and economic way

50. We do not believe our proposals will have a significant impact on our resources or the way in which we use them. On the contrary, by requiring firms to establish and implement clear and effective policies and procedures for earlier intervention, they should enhance our ability to supervise firms effectively and enforce compliance with the rules where there are breaches.

The principles that a burden or restriction should be proportionate to the expected benefits

51. We have concluded that our proposals will not impose costs of more than minimal significance. More generally, we are satisfied that any burdens imposed on firms by the proposed rules and guidance would be proportionate to the expected benefits.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

52. We do not believe our proposals undermine this principle. The proposals seek to address unsustainable credit that can lead to over-indebtedness and debt-related problems and defaulting customers are expensive to firms.

The general principle that consumers should take responsibility for their decisions

53. Our proposals are intended to place greater responsibility on credit card firms to intervene earlier and take action where consumers are at risk of financial difficulties. In some circumstances the appropriate action will be to notify the customer of the risk of escalating debt, or provide details of debt advice bodies, steps which place responsibility for further action on consumers.

The responsibility of senior management of persons subject to requirements imposed by or under the FSMA, including those affecting consumers, in relation to compliance with those requirements

54. Our proposals are not inconsistent with this general principle. We are proposing that firms should establish, implement and maintain policies for dealing with customers at risk of financial difficulties although we do not propose that responsibility for these will explicitly sit with senior management.

The desirability of the FCA exercising its functions in a way which recognises differences in the nature and objectives of business carried on by different persons

55. The emphasis on proportionality in our rules recognises that firms may have different data available to them on their customers and different products with different levels of risk to consumers. We are keen to avoid over-prescription and our proposed approach allows firms to use the data they have in their possession, rather than specifying particular data they must acquire if they do not have access to it. This would have the potential to create an issue for firms with different business models.

The desirability of publishing information relating to persons

56. We do not consider our proposals undermine this principle and that it is unlikely to be relevant, given that our proposals do not involve publishing information relating to persons.

The principle that we should exercise our functions as transparently as possible

57. We are an open and transparent regulator. While developing these proposals, we invited stakeholders to comment and provide their views on the proposal for earlier intervention.

Appendix 1
Draft Handbook text

CONSUMER CREDIT (EARLIER INTERVENTION AND PERSISTENT DEBT) INSTRUMENT 2017

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):

(1) section 137A (General rule-making power);
(2) section 137T (General supplementary powers); and
(3) section 139A (The FCA's power to give guidance).

B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. The Consumer Credit sourcebook (CONC) is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Consumer Credit (Earlier Intervention and Persistent Debt) Instrument 2017.

By order of the Board
[*date*] 2017

Annex

Amendments to the Consumer Credit sourcebook (CONC)

In this Annex, underlining indicates new text and striking through indicates deleted text unless otherwise stated.

6 Post contractual requirements

…

6.7 Post contract: business practices

…

Business practices

6.7.2 R ~~A~~ Except in relation to credit cards, a *firm* must monitor a *customer's* repayment record and take appropriate action where there are signs of actual or possible repayment difficulties.

[**Note:** paragraph 6.2 of *ILG*]

6.7.3 G …

Business practices: credit cards

6.7.3A R A *firm* must monitor a credit card *customer's* repayment record and any other relevant information held by the *firm* and take appropriate action where there are signs of actual or possible financial difficulties.

6.7.3B G (1) Circumstances in which there are signs of actual or possible financial difficulties include where there is a significant risk of one or more of the matters set out in *CONC* 1.3.1G(1) to (7) (Guidance on financial difficulties) occurring in relation to the credit card *customer*.

(2) Examples of appropriate action as referred to in *CONC* 6.7.3AR would include the *firm* doing one or more of the following, as may be relevant in the circumstances:

(a) considering suspending, reducing, waiving or cancelling any further interest or charges (for example, when a *customer* provides evidence of financial difficulties and is likely to be unable to meet payments as they fall due or is only able to make token payments, where in either case the level of debt would continue to rise if interest and charges continue to be applied);

(b) accepting token payments for a reasonable period of time in order to allow a *customer* to recover from an unexpected income shock, from a *customer* who demonstrates that meeting the *customer's* existing debts would mean not being able to meet the *customer's* priority debts or other essential living expenses (such as in relation to a mortgage, rent, council tax, food bills and utility bills);

(c) notifying the *customer* of the risk of escalating debt, additional interest or charges and of potential financial difficulties; and

(d) providing contact details for *not-for-profit debt advice bodies* and encouraging the *customer* to contact one of them.

(3) A *customer* paying the minimum amount required under the agreement is not, by itself, a sign of possible or actual financial difficulties under *CONC* 6.7.3AR. It may, however, be such a sign where, for example, a *customer* with a pattern of paying more than the minimum required payment reduces the payments to the minimum required payment due, but their pattern of drawing down *credit* on the card does not materially change.

(4) In determining what is "appropriate action" under *CONC* 6.7.3AR, a *firm* should take into account any steps it has taken under *CONC* 6.7.30R, *CONC* 6.7.31R or *CONC* 6.7.37R.

6.7.3C R A *firm* must establish, implement and maintain an adequate policy for identifying and dealing with *customers* showing signs of actual or possible financial difficulties, even though they may have not missed a payment.

6.7.3D G The policy referred to in *CONC* 6.7.3CR is in addition to the policy required under *CONC* 7.2.1R.

…

Credit cards: persistent debt

6.7.27 R (1) This *rule* applies to a *firm* with respect to communicating with a *customer* about, and receiving payments or exercising rights under, a credit card agreement if the *firm* assesses that the amount the *customer* has paid to the *firm* towards the credit card balance over the immediately preceding 18 *month* period comprises a lower amount in principal than in interest, fees and charges.

(2) A *firm* must assess whether the condition in paragraph (1) is met at least once a *month*.

(3) The *rule* in paragraph (1) does not apply:

(a) where the balance on the credit card was below £200 at any point in the 18 *month* period;

(b) where the *firm* has sent a communication to the *customer* in accordance with paragraph (4) in the preceding 18 *months* in relation to the credit card; or

(c) where the *firm* is taking steps to treat the *customer* with forbearance under *CONC* 6.7.37R, is otherwise taking equivalent or more favourable steps in relation to the *customer's* account, or *CONC* 6.7.39R applies.

(4) Where the *rule* in paragraph (1) applies in relation to a credit card *customer*, a *firm* must, in an appropriate medium (taking into account any preferences expressed by the *customer* about the medium of communication between the *firm* and the *customer*) and in plain language:

(a) notify the *customer* that, in the preceding 18 *months*, the amount the *customer* paid comprised a lower amount in principal than in interest and charges;

(b) explain that increasing this level of payment would reduce the cost of borrowing and the amount of time it would take to repay the balance;

(c) encourage the *customer* to contact the *firm* to discuss the *customer's* financial circumstances and whether the *customer* can increase the amount of payments without an adverse effect on the *customer's* financial situation;

(d) warn the *customer* that if their payments comprise a lower amount in principal than in interest and charges in two consecutive 18-*month* periods, the account may be suspended, which may be reported to *credit reference agencies*; and

(e) provide contact details for *not-for-profit debt advice bodies* and encourage the *customer* to contact one of them.

6.7.28 G For the purposes of *CONC* 6.7.27R, *CONC* 6.7.30R, *CONC* 6.7.34G, *CONC* 6.7.39R and *CONC* TP 8,“principal” comprises only the amount of *credit* drawn down by the *customer* under the credit card agreement, and does not include any interest, fees or charges added to the account.

6.7.29 R (1) This *rule* applies in respect of a credit card *customer* to whom a *firm* is required to have sent a communication under *CONC* 6.7.27R(4).

(2) The steps required under paragraphs (3) and (4) must be taken:

(a) no earlier than nine *months* after; and

(b) no later than 10 *months* after,

the date on which the requirement to send a communication under *CONC* 6.7.27R arose.

(3) The *firm* must:

(a) consider the pattern of payments made by the *customer* over the period beginning on the date on which the requirement to send a communication under *CONC* 6.7.27R(1) arose and ending on the date the *firm* takes steps under paragraph (2); and

(b) assume that this will be representative of the *customer's* payment pattern in the entire 18-*month* period immediately following the date on which the requirement to send a communication under *CONC* 6.7.27R(1) arose.

(4) If the analysis in (3) indicates that it is likely that *CONC* 6.7.30R will apply with respect to the *customer*, the *firm* must repeat the steps required under *CONC* 6.7.27R(3).

(5) The *rule* in paragraph (1) does not apply where the *firm* is already taking steps equivalent to, or more favourable than, those required under *CONC* 6.7.37R.

6.7.30 R (1) This *rule* applies:

(a) in respect of a credit card *customer* to whom a *firm* is required to have sent a communication under *CONC* 6.7.27R (1); and

(b) where the amount that the *customer* has paid to the *firm* towards the credit card balance, over the 18-*month* period immediately following the date on which the requirement to send a communication under *CONC* 6.7.27R(1) arose, comprises a lower amount in principal than in interest and charges.

(2) This *rule* does not apply:

(a) where the balance on the credit card was below £200 at any point in the 18-*month* period;

(b) to any part of the balance on the credit card that has previously been subject to the requirements of paragraph (3).

(3) A *firm* must take reasonable steps to assist a credit card *customer* that falls under paragraph (1) to repay the balance on their credit card as it stands at the end of the period specified in that paragraph more quickly and in a way that does not adversely affect the *customer's* financial situation.

6.7.31 R Where a *firm* is required to assist a *customer* to repay more quickly under *CONC* 6.7.30R(3), a *firm* must contact the *customer* to:

(1) explain that increasing this level of payment would reduce the cost of borrowing and the amount of time it would take to repay the balance;

(2) provide contact details for *not-for-profit debt advice bodies* and encourage the *customer* to contact one of them;

(3) set out options for the *customer* to increase payments and request that the *customer*, within a specified reasonable period, respond to either:

(a) confirm that the *customer* will increase payments in accordance with one of the options; or

(b) where applicable, confirm that the options proposed are not *sustainable* for the *customer*;

(4) inform the *customer* that if the *firm* does not receive a response to the request under paragraph (3) in the time specified, the *firm* will suspend or cancel the use of the credit card.

6.7.32 G (1) The options a *firm* may set out under *CONC* 6.7.31R(3) include increasing the amount of *monthly* payments on the credit card under a repayment plan, or transferring the balance on the credit card to a fixed-sum unsecured personal loan.

(2) *CONC* 6.7.31R does not prevent a *firm* from treating the *customer* more favourably, for example by writing off the balance on the account. *CONC* 6.7.31R does not apply where the *firm* is already taking steps equivalent to, or more favourable than, those required under *CONC* 6.7.37R, provided that the *firm* continues to take those steps.

6.7.33 G (1) The aim of the options a *firm* sets out under *CONC* 6.7.31R(3) should be that the *customer* repays the balance in a reasonable period.

(2) The *FCA* expects a "reasonable period" under paragraph (1), *CONC* 6.7.37R and *CONC* 6.7.38G to usually be between three and four years.

6.7.34 G References in *CONC* 6.7.27R, *CONC* 6.7.31R(3) and *CONC* 6.7.32G(1) to a *customer* increasing payments to the *firm* include circumstances where the amount a *customer* pays remains fixed at the same amount the *customer* was previously paying but, assuming there is no further spending on the card, represents an increase in the percentage of the outstanding principal that is repaid each *month* as the balance reduces.

6.7.35 R (1) Where a *customer* does not respond to a *firm's* request under *CONC* 6.7.31R(3), a *firm* must, at the end of the period specified in the request, suspend or cancel the *customer's* use of the credit card.

(2) Where a *customer* confirms that one or more of the options proposed under *CONC* 6.7.31 R(3) is *sustainable*, but states that they will not make the increased payments, a *firm* must suspend or cancel the *customer's* use of the credit card.

(3) Where a *firm* suspends the *customer's* use of the credit card under paragraph (1) and the *customer* subsequently responds to the *firm's* request under *CONC* 6.7.31R(3), the *firm* may withdraw the suspension if this would be in line with the other provisions in this section.

6.7.36 G Where a *firm* suspends or cancels the *customer's* use of the credit card under *CONC* 6.7.35R the *firm* is not, unless the *customer* responds to the *firm's* request under *CONC* 6.7.31R(3), required to take further steps under *CONC* 6.7.37R to *CONC* 6.7.39R. *Firms* are however reminded of *CONC* 6.7.3AR, which requires *firms* to take appropriate action where there are signs of actual or possible financial difficulties, and *CONC* 7.3.4R, which requires *firms* to treat *customers* in default or arrears difficulties with forbearance and due consideration.

6.7.37 R Where a *customer*:

(1) confirms to the *firm* that the options set out under *CONC* 6.7.31R(3) are *unsustainable*; or

(2) informs the *firm* that they will increase payments in accordance with one of the options proposed under *CONC* 6.7.31G(3) but the patterns of payments actually made under the repayment plan after it is put in place, or other indicators, show that the *customer* is unlikely to repay the balance in a reasonable period,

the *firm* must treat the *customer* with forbearance and due consideration.

6.7.38 G (1) The steps a *firm* takes to treat a *customer* with forbearance under *CONC* 6.7.37R should have the aim of assisting the *customer* to make *sustainable repayments* to repay the outstanding balance in a reasonable period, and may include reducing, waiving or cancelling any interest or charges.

(2) The *FCA* expects that it will generally be necessary for *firms* to suspend or cancel the use of the credit card of a *customer* that the *firm* is required to treat with forbearance under *CONC* 6.7.37R with a view to ensuring the *customer* repays the outstanding balance in a reasonable period. This expectation does not apply, however, where the suspension or cancellation of use of the credit card would cause a significant adverse impact on the *customer's* financial situation, for example where the *customer* depends on the credit card for meeting

essential living expenses (such as in relation to a mortgage, rent, council tax, food bills and utility bills). Equally, the *FCA* considers that it will generally not be appropriate to withdraw the suspension of the use of a credit card of a *customer* under *CONC* 6.7.35R(3) if the *firm* is required to treat the *customer* with forbearance under *CONC* 6.7.37R.

6.7.39 R Where a *firm* does not suspend or cancel the use of the credit card of a *customer* falling under *CONC* 6.7.30R, the *firm* must take reasonable steps to ensure that the *customer* does not, in the 18-*month* period immediately following, repay an amount to the *firm* towards the credit card balance that comprises a lower amount in principal than in interest and charges in relation to any spending on the card in this period.

6.7.40 G Compliance with the any of the requirements in *CONC* 6.7.27R to *CONC* 6.7.39R does not remove or reduce the obligation on a *firm* to:

(1) take appropriate action where there are signs of actual or possible financial difficulties under *CONC* 6.7.3AR; or

(2) treat *customers* in default or arrears difficulties with forbearance and due consideration under *CONC* 7.3.4R,

and vice versa.

After CONC TP 7 (Transitional provision in relation to the Consumer Credit (Amendment No 2) Instrument 2015) insert the following new transitional provisions. The text is not underlined.

TP 7A Transitional provisions in relation to the Consumer Credit (Earlier Intervention and Persistent Debt) Instrument 2017

(1)	**(2) Material to which the transitional provision applies**	**(3)**	**(4) Transitional provision**	**(5) Transitional provision: dates in force**	**(6) Handbook provision: coming into force**
…					
7A.1	*CONC* 6.7.2R, *CONC* 6.7.3AR to *CONC* 6.7.3DR, and *CONC* 6.7.27R to *CONC*	R	A *firm* may comply with *CONC* as if the changes made by the Consumer Credit (Earlier Intervention and Persistent Debt) Instrument 2017 had not	[*3 months after coming into force date*]	

	6.7.40G		been made until [*3 months after coming into force date*].		
7A.2	*CONC* 6.7.27R to *CONC* 6.7.40G	G	The effect of TP 7A.1 is that on [*date 3 months after coming into force date*] *firms* must start to look back at credit card *customers'* repayment records over the preceding 18-*month* period and identify any *customers* that fall within the application of *CONC* 6.7.27R (and must thereafter continue to do so on at least a *monthly* basis). *Firms* must then send those *customers* a communication in accordance with *CONC* 6.7.27R(3). Between 9 and 10 *months* after this communication is required to be sent, *CONC* 6.7.29R requires *firms* to take the additional steps set out in that *rule* with respect to that group of *customers*. 18 *months* after this communication is required to be sent, *CONC* 6.7.30R to *CONC* 6.7.40R potentially require the *firm* to take the further steps described in those *rules* in relation to that group of *customers* where *CONC* 6.7.30R applies. *CONC* 6.7.30R applies only where the amount that *customer* has paid to the *firm* towards the credit card balance, over the 18-*month* period following the date on which the *CONC* 6.7.27R communication was triggered, comprises a lower amount in principal than in interest and charges.	[*3 months after coming into force date*]	

			This means that the earliest date on which a *firm* may have obligations under *CONC* 6.7.30R is [*date 21 months after coming into force date*].		

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