FINANCIAL CONDUCT AUTHORITY

Rent-to-own and alternatives to high-cost credit – feedback on CP18/12 and consultation on a price cap

Consultation Paper
CP18/35***

November 2018

How to respond

We are asking for comments on this Consultation Paper (CP) by 17 January 2019

You can send them to us using the form on our website at: www.fca.org.uk/cp18-35-response-form

Or in writing to:
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020 7066 4245

Email:
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takes you to helpful abbreviations

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1 Summary

Why we are consulting

1.1 In our consultation paper of May 2018, CP18/12, we explained that there was a case for considering introducing a price cap in the Rent-to-own (RTO) market. We have since analysed the market further, including in-depth data analysis and a survey of RTO consumers. We are now consulting on introducing such a price cap from 1 April 2019 to address harm to vulnerable consumers from high prices.

1.2 We have taken action previously on prices where consumers are being misled with unclear pricing and information, or where they are being given unaffordable loans and have a high risk of ending up in arrears. We have already taken supervisory action on these issues in this sector.

1.3 We believe we need to intervene in the RTO market because a highly vulnerable group of consumers are paying too much for household goods. We understand that there is a cost to firms for the risk of providing credit, and there are significant risks involved in serving a population with low credit scores. But our view is that the prices firms charge for servicing a vulnerable consumer base can cause harm simply because they are too high.

1.4 We have clear evidence of RTO users' vulnerability. Only one third of RTO consumers are in work and most have low incomes. They are more likely to live in the most deprived areas of the UK, a quarter say they have missed a bill payment in the last 6 months and a third have suffered anxiety or stress due to financial difficulties. They are the least creditworthy individuals compared with other users of high cost credit.

1.5 High product prices, high interest charges and add-ons can lead to high total costs. Given that most consumers purchase both insurance and extended warranties, we estimate that the total cost of a typical RTO agreement will be around 3 times the median mainstream retail price. This means that an RTO customer may pay £800 over three years for a fridge that would cost £260 on the high street. In some cases, prices are 4 or even 5 times the median retail price.

1.6 Our consumer research shows that RTO customers focus on weekly repayments more than the total cost of credit. RTO products are designed around the weekly budgeting of most RTO consumers. Total costs have limited impact on most of these consumers' decisions. Simply being accepted for credit is also an important factor in consumers' use of RTO – 30% of our survey respondents said that 'being accepted' was their priority when taking out an RTO agreement. Evidence from our survey also shows that most RTO customers believe that they either have no or very limited alternative options to get the household goods they need.

1.7 RTO consumers are also more likely to have low levels of financial literacy. Our survey results suggest that many of them do not understand the basic relationship between weekly repayments, term lengths and interest costs, with only 29% of consumers surveyed able to correctly answer questions asked about this. The way firms present

RTO component pricing (the mark up of the original goods and interest rate) may complicate this further.

1.8 As a result, the way consumers make decisions puts limited restraint on the total costs that firms charge. The harm in this market is concentrated on a consumer group that needs to be protected from high RTO prices which mean they can pay several times more than what other people pay for goods.

1.9 Behavioural economics and psychological studies of low income consumers back up findings from our own research that RTO customers face constraints on their decision-making which lead them to give less weight to long term factors such as total costs. This means even if we required firms to give consumers more information about these products ('disclosure') this would still not reduce prices. Most importantly, disclosure would not be relevant for consumers who believe they have no other options.

1.10 We estimate that the benefits of the cap will outweigh the downsides. Given these consumers' vulnerability and stretched finances, the amounts they save by taking out a lower priced RTO agreement will be particularly beneficial.

1.11 We know that a potential result of our intervention is that some consumers may lose access to RTO and they will have to make difficult trade-offs to get the goods or go without them. Over time, alternatives to high-cost credit could give these consumers better choices, but these alternatives will be limited in the short to medium term. In Chapter 6 we set our approach to promoting the availability and awareness of alternatives to high-cost credit, and the actions we are taking.

1.12 We are also making final rules to introduce a ban on concluding the sale of extended warranties at the point of sale of the RTO agreement. This should help consumers decide whether they want to buy this product by removing the point of sale advantage that firms currently have. However, this alone does not deal with the total cost RTO consumers pay.

Who this applies to

1.13 This document should be read by firms offering hire purchase and/or conditional sale, consumer groups and debt advice organisations.

1.14 It will also be of interest to providers of alternatives to high-cost credit, as well as consumer hire firms.

1.15 If we introduce a price cap as proposed, it will affect consumers considering purchasing household goods using RTO from 1 April 2019.

The wider context of this consultation

1.16 High-cost credit markets have been a priority for our work since we took over the regulation of consumer credit in 2014. We launched our high-cost credit review in November 2016. In May 2018, we consulted on a range of measures designed to address consumer harm from RTO, home-collected credit, catalogue credit, store cards and overdrafts.

1.17 In Chapter 2 we explain why we believe our proposed interventions in the RTO market are necessary to reduce harm, how they complement our other work on high-cost credit and how they further our consumer protection objective.

What we want to change

1.18 We want to bring down prices on RTO agreements where the overall costs to consumers are high relative to other retailers' prices. Our proposed price cap on RTO products is designed to control prices by:

- setting a total credit cap of 100%
- introducing a requirement on firms to benchmark base prices (prices before any added products like warranties etc) against retail prices
- preventing firms increasing their prices for insurance premiums (e.g. theft and accidental damage cover) or arrears charges in order to recoup lost revenue from the price cap.

1.19 Chapter 4 sets out these proposals in more detail.

Extended warranties

1.20 Having consulted in May (CP18/12), we are now making the following final rules on the sale of extended warranties.

a. A point of sale ban on the sale of extended warranties alongside the sale of the RTO agreement ('the point-of-sale ban'). Firms will be required to allow two clear days before consumers can actively opt-in to buy these.

b. New requirements on firms to provide information to consumers to help them decide whether to buy the extended warranty. This information will include the price in terms of weekly, annual and length of contract cost, as well as how the extended warranty relates to the manufacturer's warranty and any theft and accidental damage insurance.

1.21 Chapter 5 sets out our approach to extended warranties in more detail.

Measuring success

1.22 We estimate that our proposed price cap could deliver net consumer benefits of between £19.6m and £22.7m a year. If we implement a price cap after this consultation, we would monitor its effects on the RTO market and its consumers.

1.23 We do not propose to introduce new regulatory reporting requirements for firms at this stage. This is a small market with relatively few active firms, and so a more targeted approach can inform our understanding of the effect of a price cap. We can:

- Update our analysis of comparative pricing to monitor the impact of the cap on overall prices
- request data from firms on an ad hoc basis – e.g. evidence of firms' benchmarking
- act on feedback and intelligence from our consumer contact centre

1.24 If made into final rules that come into effect on 1 April 2019, we will start an evaluation of the impact of the price cap in April 2021.[1]

Next steps

RTO price cap consultation

1.25 Please respond to the consultation questions in this paper by 17 January 2019 by emailing cp18-35@fca.org.uk. Depending on respondents' views, we aim to finalise these rules at the beginning of March 2019 and for them to come into force on 1 April 2019.

1.26 Once the rules are in force they will apply immediately to any new products RTO firms introduce to the market for the first time. For products that RTO firms are already offering, the rules will apply either at the point the RTO firm makes a price change or once the rules have been in force for three months (whichever date is sooner).

RTO warranties

1.27 The final rules included in Appendix 2 and summarised in Chapter 5 come into force on 22 February 2019.

1 https://www.fca.org.uk/publications/corporate-documents/evaluating-our-work

2 The wider context

2.1 We have been tackling issues in the Rent-to-own sector since we took over regulation of consumer credit in 2014. We now require RTO firms to be more transparent when displaying the cash value of goods, the amount of interest to be paid, and the total cost to customers. Firms have made substantial improvements, particularly in the way they assess creditworthiness and deal with consumers in financial difficulty. Our work has also resulted in redress packages for around 340,000 consumers of RTO firms- BrightHouse, PerfectHome and Buy As You View, of nearly £16m.

2.2 Our new rules on extended warranties will address specific harm caused by firms' sales practices. Even if a price cap is later implemented, there are still benefits in introducing these rules. The point of sale ban addresses a different harm. This is that firms have an advantage at the point of sale and consumers will be better able to decide whether they value the additional service of an extended warranty when they are not making their main purchase decision.

2.3 The proposals for a price cap described in this CP address the remaining issue of vulnerable consumers paying too much for household goods.

High cost credit review – other products

2.4 RTO is just one part of our high-cost credit review. We are developing proposals for consultation and finalising measures that we consulted on in May 2018. These include measures on overdrafts, home-collected credit, catalogue and store cards and buy now pay later deals. Across the sector, these steps we are taking aim to support markets in which credit is fair, accessible and appropriate, particularly for vulnerable consumers. To achieve this, we are taking into account the specific harms and drivers of harm that we see for the different products. We are developing a robust package of measures to target those specific harms, with the common aim of improving outcomes for vulnerable consumers.

2.5 In May, we said the overdrafts market needed fundamental change and we have since carried out extensive further analysis. We will shortly publish our conclusions and proposals for overdrafts, and will also publish the results of our Strategic Review of Retail Banking. We will also be publishing our conclusions and proposals on the other measures that we consulted on for home-collected credit, for catalogue credit and store cards, and buy now pay later deals.

2.6 During our high-cost credit review, we have taken into account that people use high-cost credit products for numerous and complex reasons. In particular, consumer demand for some high-cost credit products increases with the limited availability of alternatives to high-cost credit, and with low awareness of the existing alternatives. We have been working to address this issue with stakeholders across Government, the private sector and the voluntary sector to develop effective approaches.

2.7 In our CP in May, we set out a number of areas where we believed action would have an impact on promoting access to and awareness of alternatives. In Chapter 6 we provide an update on the various aspects of our work on alternatives to high-cost credit, including our work with other stakeholders.

How this consultation links to our objectives

Consumer protection

2.8 We aim to make financial markets work well so that consumers get a fair deal and to secure an appropriate degree of protection for consumers.

2.9 As explained in Chapter 1, and later in this document, we consider it is necessary to intervene on high prices in this market. Our proposals are designed to improve outcomes for vulnerable consumers paying the highest prices for using RTO, by reducing the total costs they pay.

Equality and diversity considerations

2.10 We have considered the equality and diversity issues that may arise from the proposals in this Consultation Paper. We consider this further in Annex 10 in our Equality Impact Assessment.

3 Our approach to considering a price cap and findings

3.1 In CP18/12, we announced that we needed to carry out further work to decide on whether to consult on a price cap in the RTO market. We also said that in the interim we would remain open to alternative solutions that could protect consumers from the harm caused by high costs, and welcomed stakeholders' views on this.

3.2 We have gathered evidence to:

- update our analysis of pricing in the RTO sector
- assess the potential for, and nature of, harm from high RTO prices
- refine our understanding of how consumers use RTO and what other options they have
- assess possible interventions to deal with high RTO prices
- carry out analysis to estimate the consequences of a price cap for firms and consumers

3.3 We have gathered evidence from a number of sources:

- data from the two largest RTO firms, including detailed loan level records, consumer information and management accounts
- further analysis of credit reference agency (CRA) data on consumers in the RTO sector
- a survey of 1200 RTO consumers and declined applicants carried out by PwC research
- additional research on pricing in the RTO sector compared with other retailers. (see Annex 8)
- international case studies on price caps in RTO or comparable sectors in other countries (see Annex 5)

3.4 We have also considered the feedback we received to the discussion questions in CP18/12 about our approach to a price cap.

3.5 We fully describe how we undertook our analysis in the CBA and annexes.

Responses to CP18/12 on price capping

3.6 In CP18/12, we asked 2 questions:

Q1: ***What alternative solutions could there be to address harm from high prices?***

Q2: ***What issues should we take into account in carrying out further work on a price cap?***

3.7 In Annex 3 we set out a full summary of the feedback we received. In short, most respondents to the discussion questions in CP18/12, most of whom were from consumer groups, supported some form of intervention to tackle RTO pricing. Most favoured some kind of price cap.

3.8 However, responses from RTO firms stressed the potential negative consequences of a price cap to consumers and the market. They also highlighted the challenges of designing and implementing a price cap, given the complexities of the RTO business model and related costs.

3.9 Many respondents suggested alternative ways to address harm from high prices, and some argued these should be combined with a price cap.

3.10 In response to Q.2 respondents suggested a range of questions we ought to address. The questions broadly fit into the following categories, and these categories have informed our approach to the analysis:

- is pricing in the RTO sector causing harm to consumers?
- is a price cap the most proportionate and effective way to address that harm?
- if a price cap is the most effective remedy, what structure and level of cap would deliver the best outcomes for consumers?
- what is the impact of that cap on firms and consumers?

Findings from our analytical work

The RTO Sector

3.11 RTO retailers offer a range of household goods over a period of 1 to 3 years under a hire-purchase agreement. Consumers typically make weekly payments and have the option to take ownership of the goods when they have made all the payments.

3.12 Consumers have outstanding debt on 2.4 agreements on average and the average weekly repayment is £28. Our quantitative survey found that the most common reason for RTO purchases was that the consumer's current item had broken (44% of consumers, rising to 74% for white goods). 33% wanted a better or newer product. 90% of consumers buying household appliances say their purchase was essential, dropping to 51% for electronics.

3.13 Two firms, BrightHouse and PerfectHome, account for just over 90% of outstanding RTO agreements. As of November, 2017 there were approximately 300,000 customers with outstanding RTO debt across the market.

Pricing

3.14 In CP18/12, we published an analysis of RTO pricing. It showed that, on the longest term deals available, average prices were 2.7 times more than retail prices including credit costs and 3.7 greater where add-ons were included. Some prices were significantly in excess of these average figures.

3.15 We have updated and expanded our analysis of RTO pricing. We looked across all product term lengths, rather than just the longest-term agreements discussed in CP18/12. We also looked at the third largest firm in the market, which offers RTO products at lower interest rates and does not sell insurance products.

3.16 We also looked at data on credit agreements from the two largest firms, which gives us information on the cost of actual agreements. This shows how many consumers take out agreements of different lengths and take out insurance and warranties, all of which are important to the total costs of the agreement.

3.17 We looked at a range of roughly 50 products at each of two largest firms and one other. Table 3.1 shows the results from agreements with the longest terms for the two largest firms. Because of their term length, these agreements have the highest total costs.

3.18 High base prices compared to other retailers,[2] and the impact of accumulated interest over relatively long terms (e.g. 3 years) lead to total costs that are often more than twice as expensive as cash prices at other retailers. The total costs to consumers is further increased by add-on products, which most RTO users buy.[3]

Table 3.1: Extract of analysis of RTO pricing (October 2018[4])
Longest Financing Term

Firm	Product Category		Base Price Multiple (includes delivery and installation) Relative to High Street	Term (weeks)	Relative to High Street		
					Total Relative Financing Multiple	Plus Insurance	Plus Extended Warranties and Insurance
Firm 1	Appliances	**Mean**	**1.6**	156	**3.1**	**3.7**	**4.4**
		Highest	1.8		3.6	4.2	5.3
	Technology	**Mean**	**1.4**	80	**2.3**	**2.8**	**2.9**
		Highest	1.5		2.4	3.0	3.1
	TV & Audio	**Mean**	**1.6**	156	**3.1**	**2.2**	**3.9**
		Highest	1.7		3.3	3.8	4.2
Firm 2	Appliances	**Mean**	**1.1**	156	**2.4**	**2.7**	**3.3**
		Highest	1.4		3.0	3.3	4.2
	Technology	**Mean**	**1.3**	78	**2.0**	**2.4**	**2.8**
		Highest	1.7		2.7	3.1	3.6
	TV & Audio	**Mean**	**1.0**	156	**2.2**	**2.4**	**2.8**
		Highest	1.1		2.3	2.5	2.9

2 Relative base prices differ across firms and products. We note that one firm's relative base prices appear to be lower in October 2018 than when we did the same exercise for CP18/12.

3 Our data indicates that as of November 2017 90% of consumers had purchased theft and accidental damage insurance, and 70% had purchased an extended warranty. We anticipate that fewer consumers will purchase extended warranties as a result of the incoming point of sale ban.

4 All columns include delivery and installation for both retail and RTO pricing.

3.19 Most consumers purchase both insurance and extended warranties and we estimate that a typical RTO agreement will be around 3 times the median mainstream retail price. In some cases, prices are 3 or 4 times the retail price. Looking at actual agreement data for the past year confirms what we see in the pricing comparison.

3.20 Firms have argued that there are valid reasons why their base prices are higher than other retailers. Whether or not base prices reflect firms' costs, we are concerned that high base prices can lead to a 'multiplier effect' on the total costs to consumers. Regardless of why prices are high, consumers pay much more for products from RTO firms once credit is included, and this cost is then further increased by add-ons.

3.21 The largest cost multiples we see are where consumers chose insurance and extended warranties. We understand that insurance gives consumers additional value and so comes at an extra cost. However, the 2 largest RTO firms make holding insurance for products compulsory and although consumers could theoretically get cover elsewhere, most do not.

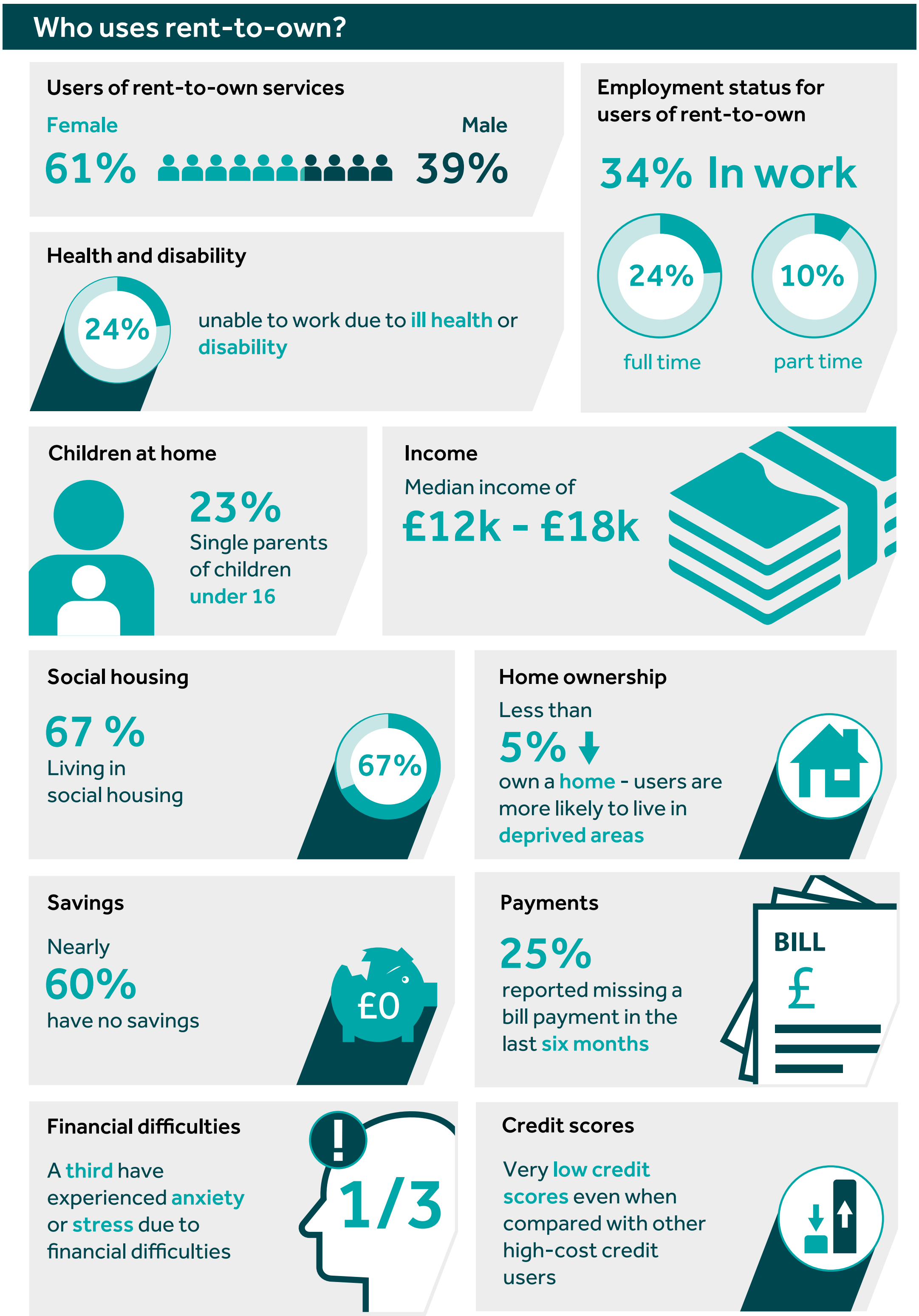
3.22 We have finalised our rules so that consumers can make a more informed choice about extended warranties – and we expect a reduction in the number of consumers who chose them. However, these additional products will still contribute to the overall costs to consumers.

Consumer profile and vulnerability

3.23 In Our Mission, we made clear that we will prioritise the needs of the most vulnerable and least resilient groups of consumers.

3.24 In our Approach to Consumers, we confirmed our definition of a vulnerable consumer as 'someone who, due to their personal circumstances is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care'.

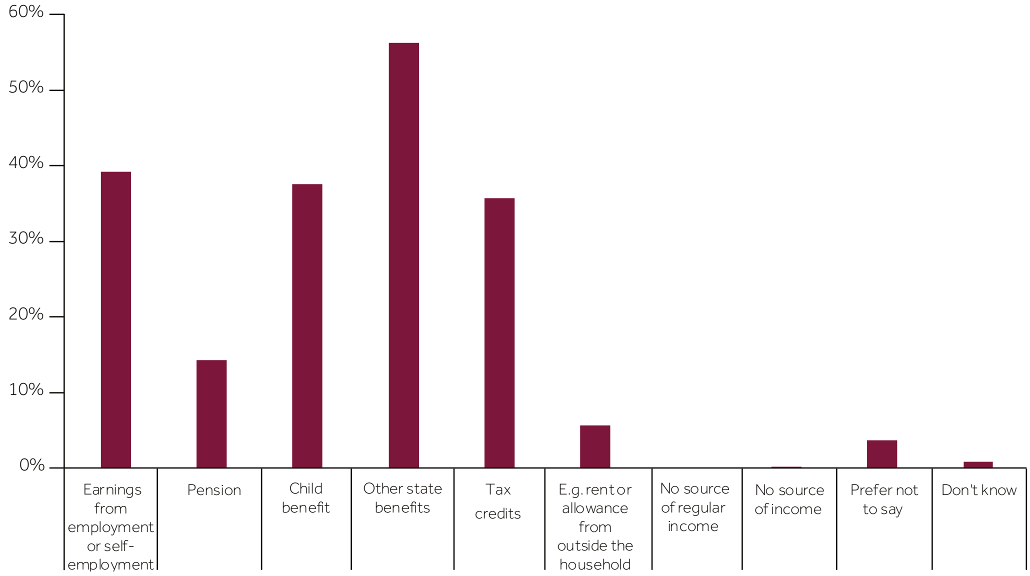
3.25 Our consumer survey and further CRA data analysis indicate that RTO customers are amongst the most vulnerable users of credit.



3.26 RTO customers typically have very low levels of income and are in difficult financial situations. Any financial harm is likely to have a greater impact on their well-being compared with the population as a whole. We believe there are a number of ways in which consumers could be considered vulnerable when taken together.

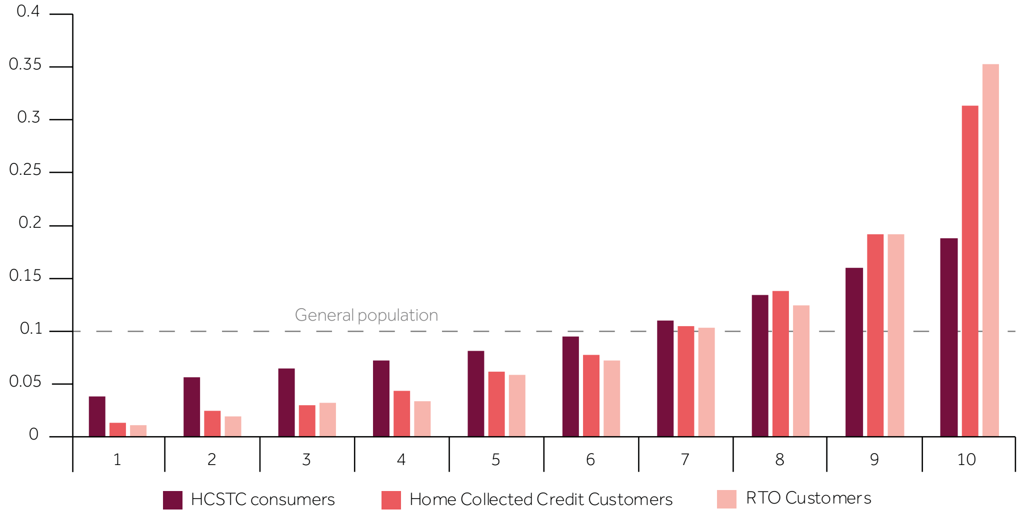
3.27 RTO consumers are disproportionately single, working age, and female. Only approximately one third are currently employed, and 10% are employed part-time. The median income for RTO consumers is between £12,000 and £18,000, compared with the UK median income of £28,430. Fewer than 40% of RTO consumers' households have income from employment. More than half receive some form of state benefit, making it the most common source of income. Nearly 60% of consumers said they had no savings.

Figure 3.1: Income sources for RTO customers' households



3.28 24% of RTO consumers are unable to work due to illness or disability. 23% are single parents of children under 16, compared to around 9% of all households in the general population.

Figure 3.2: Percentage of customers by deciles of index of multiple deprivation



3.29 We found that more than two thirds of RTO consumers live in social housing, and less than 5% own their own home. Our analysis of CRA data and data from the Office of National Statistics (ONS) shows that RTO consumers are much more likely to live in an area with high levels of deprivation, even more so than high-cost short-term credit (HCSTC) users, and in similar areas to home collected credit users.

3.30 A quarter of RTO consumers said they had missed a bill payment in the last 6 months, and a third have suffered anxiety or stress due to financial difficulties.

3.31 Many RTO consumers are in difficult financial circumstances, where decisions about even small amounts of expenditure may involve uncomfortable trade-offs, such as choosing which bills to pay. Any income shocks or unexpected expenditure are likely to have a more serious impact on their well-being than on the population as a whole. For example, consumers with no savings and limited incomes may have to cut back on essential spending or miss payments if they have any funding shortfalls.

Alternative purchase and credit options

3.32 We have assessed how far RTO users have other means of buying the products they want or of using other forms of credit. Our research for CP18/12 showed that, as of November 2016, 52% of RTO consumers held home-collected credit debts, and 46% held catalogue credit debts. This indicates that consumers may have options to use lines of credit with lower overall costs than RTO.

3.33 Our analysis of CRA data indicates only 4% of RTO consumers had enough available credit on revolving lines of credit to cover the cost of their RTO purchase at the point they bought it. However, we also used CRA data to look at the amount of new credit that consumers with similar characteristics to RTO consumers could get when they applied for it. We estimate that 19% to 24% of RTO consumers could get enough new credit from elsewhere (e.g. home-collected loans) to finance the purchase. (Annex 7: Availability of alternatives to RTO gives more detail).

3.34 This broadly matches our findings from the consumer survey, where 51% of accepted RTO consumers said RTO was their only option to access goods. Of those who said they could get the product another way, saving up (26%); paying with cash or debit card (17%); and borrowing money from friends and family (13%) were the most common options. Only 15% gave another formal credit product as an alternative means of buying the product.

3.35 The survey also found that 48% of those who were refused an RTO agreement then went without the product. Only a minority of those who got the product by other means used a form of formal credit to do so. Most paid with cash, bought a second-hand product, or borrowed from friends and family instead.

3.36 These findings suggest about half of RTO users may be able to use cash or credit as an alternative to using RTO, but the rest would be likely to go without the goods.

3.37 Our survey found that those that went without were more likely to be younger, with lower incomes, and looking to buy electronic products. 32% of consumers that went without said they suffered no consequences as a result. However a majority of those who went without white goods and furniture said it made their life more difficult or uncomfortable.

Consumer perceptions and decision-making

3.38 Our qualitative research, published in CP18/12, found that common reasons consumers gave for purchasing an item using RTO were:

- they believed that they didn't have other options;
- the affordability of weekly repayments
- the ability to get goods straight away
- being able to see and try in-store displays items with desirable brands and products
- social influence

3.39 The quantitative survey has confirmed this. 37% said they used RTO because they had used it before, 29% said RTO was their only option as they wouldn't be accepted for other credit or have funds to buy with cash, 22% pointed to low weekly repayments and 17% said the store was convenient to get to.

3.40 The quantitative survey also confirmed our earlier findings about how far RTO consumers consider the price of the product and the total costs before entering into an agreement. We found that:

- Almost a third of consumers said that they hadn't looked at the product price at all. Of those who had, nearly a quarter did not compare prices elsewhere.
- Consumers focus primarily on weekly repayments. 49% of consumers listed 'keeping weekly repayments low' as their top priority when considering their purchase options, compared with only 15% who listed keeping down the overall cost.

3.41 We also found that consumers generally have a low understanding of the relationship between weekly payment amounts and the total cost of borrowing. While more than half of RTO consumers said they could afford to pay more back each week, most didn't understand the link between paying more per week and paying less interest over time.

3.42 Consumers were generally content with their choice of using RTO. Only around 20% of consumers regret their decision to use it. This regret increases with the length of time since they bought the product. Of consumers who bought their product over a year ago, 26% regret doing so. Our survey also asked consumers who no longer use RTO if they regretted using it: just under a third did.

Harm to consumers from high prices

3.43 Our evidence confirms that consumers using RTO focus on weekly repayments. Total costs do not feature significantly in their decision-making. These consumers also focus on being accepted and getting their goods, and our evidence shows that most RTO customers think they have few alternative options for getting them.

3.44 RTO customers also have low levels of financial literacy and a strong incentive to focus on weekly cost. Our survey suggests that they do not have a clear understanding of the basic relationship between weekly repayments, term lengths and interest costs. Some RTO consumers also have, or feel they have, few or no other choices. In these circumstances, it will feel entirely logical for them to focus on a weekly cost and immediate needs.

3.45 Behavioural economics and psychological studies of how low-income consumers make borrowing decisions suggest that there are limits to how much consumers can change their decision-making behaviour. Academic literature on myopia (short-sightedness) emphasises that people tend to give short-term considerations disproportionately greater weight than longer-term ones. It also highlights that this can be exacerbated when people are dealing with an immediate crisis, as may be the case for vulnerable consumers.

3.46 Financial vulnerability also causes 'tunnelling' effects. These make people focus on the urgent need to resolve an immediate problem to the point that they cannot take into account factors which fall outside the tunnel. Not engaging with the total costs of an RTO deal is an example of this effect.

3.47 Relatively low levels of consumer regret at using RTO are unsurprising where many consumers feel they have no other options, have got the product they wanted and are likely to have given little weight to the total cost they will be pay.

3.48 From our evidence and analysis, we conclude that the upper range of prices being paid by this vulnerable consumer group, many of whom believe they have no other options, is too high. Consumers face barriers taking the total costs of RTO deals into account, which limit firms' motivation to lower total RTO prices. In these circumstances, we need to intervene to protect RTO consumers from high total costs.

3.49 We noted in CP18/12 that the costs of a standard 52-week home-collected credit loan would deliver significant savings compared with using RTO. We accept that it is difficult to make comparisons with other credit products because of different features, term lengths and different credit risk costs. We recognise that shorter term RTO loans are within a similar pricing range to home-collected credit. Lower total costs on shorter term agreements are not the focus of our concern. But we consider that the most important reference point is the multiple of retail prices that RTO consumers pay and that they are being paid by such a vulnerable group of consumers. In this context, we do not consider that paying 3, 4 or more times the cost of household goods is appropriate.

3.50 We noted in CP18/12 that using RTO can have benefits for consumers. These can include being able to hand goods back without further liability or upgrade to a new product, and these benefits may not be available to those getting goods in other ways. However, while we recognise that these benefits are an additional cost to firms, we don't believe they justify the high prices that consumers pay.

Q1: Do you agree with our assessment of harm to consumers from high prices?

What is the most effective way to address the harm identified?

3.51 We have considered a range of other options to address the harm to consumers from high prices. This includes options suggested by respondents to CP18/12, which we set out in more detail in Annex 3.

3.52 The most common alternatives to a price cap that respondents suggested were stronger disclosure requirements on firms to help consumers understand the high costs of using RTO. These would be on top of our existing requirements on advertising and disclosure. For example, we could require firms to disclose the prices that other retailers charge for identical or comparable goods. This information could include risk warnings about high costs. This information could also signpost the existence and costs of alternative credit providers or community finance organisations.

3.53 We do not think disclosure measures would be effective, for a number of reasons.

3.54 Some consumers may make different or more informed buying decisions because of improved disclosure. But in circumstances where consumer focus is on weekly repayments, getting the product and the relative lack of alternative options, this puts significant barriers in place for consumers to act differently. For example, consumers may not have the money to pay for goods up front in cash, or be eligible for other, lower-cost forms of credit to fund these purchases.

3.55 In these circumstances, the only measure that we believe will be effective in addressing the high total costs of RTO is to price cap them.

3.56 Some respondents to CP18/12 suggested that we strengthen our rules around affordability assessments to ensure that consumers only take out RTO agreements that are affordable. However, our authorisations process and supervision of firms in this sector have already driven significant improvements in firms' conduct around affordability assessments, price transparency and the treatment of consumers in arrears. This has led to a reduction in the number of consumers accepted for unaffordable RTO agreements. Additionally, the two largest RTO firms are paying redress to consumers for carrying out inadequate checks in the past. We continue to monitor this and will act where we see poor outcomes for consumers from firms failing to comply with our existing rules.

3.57 We also emphasise that the harm we see to consumers is not acute financial distress from unaffordable borrowing in the short-term, but that some consumers are paying too high a price.

3.58 Some respondents suggested that we introduce limits on how much consumers can borrow against their net income, or the number of products consumers can take at any one time. We believe that measures such as these do not address the nature of the harm we have identified, given the controls already in place around affordability.[5] A consumer holding multiple RTO products at any one time may be driven by necessity, and any harm from holding multiple agreements will be the compounded effect of high prices. Reducing prices at the individual agreement level would reduce the harm to consumers in these circumstances.

3.59 It was also suggested that we introduce tight controls on the products RTO firms should be able to provide, e.g. being limited to basic models of goods, goods available at other retailers, or 'essential goods'. We don't consider it proportionate to limit the types of goods available to consumers, which could have negative consequences. This would also not affect the prices that those goods could be sold for.

3.60 Some respondents suggested that promoting alternative, community-based and lower-cost forms of lending could protect consumers by moving them away from RTO and towards these alternatives. In CP18/12, we set out a range of actions we are taking to foster the growth of alternatives to high-cost credit and improve the availability and awareness of such schemes. We provide an update on these in Chapter 6.

Q2: Do you agree with our assessment that other measures will not be fully effective in reducing harm from high prices?

5 We confirmed our enhanced controls around affordability assessments in July 2018 in PS 18/19

4 Our Proposals

Summary

4.1 We want to reduce the total cost to consumers of RTO agreements where these costs are particularly high compared with retail prices. To do so, we need to control the individual elements that make up the overall cost. Our proposed price cap in the RTO market is designed to control prices by:

- Requiring firms to ensure that they set their base prices, including delivery and installation, at or below a level calculated by reference to other retailers' prices.
- Requiring firms to keep to a total credit cap of 100%. This will ensure that consumers do not pay credit costs higher than the price of the product, including delivery and installation.
- Preventing firms from charging RTO consumers higher prices for insurance premiums, e.g. theft and accidental damage cover, purely to recoup lost revenue once the price cap comes into effect.
- In the same way, preventing firms from changing their arrears charging structure to recoup lost revenue.

4.2 We propose that the rules will apply to RTO agreements as follows:

- for products introduced on or after 1 April, from that date
- for any product where prices are changed on or after 1 April, from the date that the price is changed
- in all other cases, from 1 July 2019.

4.3 The rules would apply both to RTO agreements arranged in store or online.

Controlling base price

4.4 Base price plays an important role in the overall cost to RTO consumers. To be effective, any price cap must include a means of controlling the base price. Otherwise firms would have an incentive to increase their base prices to limit the effectiveness of any cap on interest or financing costs on total costs.

4.5 We propose rules that would require a firm to benchmark the retail price of any product it intends to sell through RTO against the prices of other retailers. We believe this is a proportionate way in which to control base prices. Firms would need to have their own policies and procedures explaining how they do this.

4.6 We are proposing that a firm benchmarks its base price by setting it:

- no higher than the median of 3 mainstream retailers' prices (which can include no more than 1 catalogue credit retailer); and
- where a catalogue credit retailer does not sell the product, no higher than the highest mainstream retail price of the other 3 retailers.

4.7 Here, 'mainstream retailers' prices excludes other RTO firms and prices that are so far outside the range of other prices they have found that no reasonably informed consumer would be likely to pay them.[6] But it could include small, independent retailers, for example where comparisons were less readily available.

4.8 As RTO firms are relatively small, we don't expect them to be offering the cheapest cash prices and competing with large mainstream retailers. But we need to use a transparent means of anchoring their prices to avoid the risk of firms manipulating the cap and ensure it has the desired effect. We propose that firms can only include 1 catalogue credit price in their calculations. This will ensure they have to use a range of prices that must include retailers who do not mainly sell through combining products with credit.

4.9 Where the same product is not sold by other mainstream retailers, the firm would need to benchmark by finding a 'comparable product', based on, for example, quality, size, performance and functions,[7] and follow the approach outlined above. This should tackle the industry practice of giving very similar goods exclusive serial numbers, often at the request of retailers, which makes it harder to compare prices. If the RTO firm can't find three other retailers who are selling the same product, then any shortfall would need to be made-up by finding the relevant number of prices for comparable products.

4.10 For bundled products, e.g. a console and video games, we would expect firms to identify and compare using the same or similar bundles available through other retailers. We would expect firms to explain their approach in their policies and procedures.

4.11 We do not propose applying benchmarking rules to second hand goods. We think it unlikely that firms will substantially raise the price of these goods in order to limit the effect of the cap. The price of new goods will limit the price of second hand goods, as we would not expect the RTO retailer to be able to charge more for second hand goods than for new ones.

4.12 We also want to control the prices of delivery and installation, which can be financed in the same way as the retail price of the product. Our proposed rules require firms to benchmark against what other retailers charge for similar services by product type, eg washing machines or fridges, rather than individual products, e.g. model number.

4.13 It is important that firms keep their benchmarking up-to-date. So, in addition to requiring firms to benchmark base prices when they first start selling a product, our rules would also require this if they change a product's base price, and within 12 months of the last time the benchmarking was carried out. We think that this will be

6 See Appendix 1, draft rule, 5B 2.2 R (8)
7 See Appendix 1, draft guidance, 5B.2.3 G (2)

enough to prevent firms manipulating the cap and that it would be disproportionate to make firms review prices more often.

4.14 As benchmarking will be done by firms at specific points in time, it may not be easy for either firms or us to recreate these exercises for compliance or quality assurance checking. So, firms' record keeping will be especially important.

4.15 We propose requiring firms to keep records that demonstrate, in each instance, how they have set base prices for each of their products. This would include 'point-in-time' evidence of the other retail prices they benchmarked against, e.g. screengrabs of online comparisons or the results of third party benchmarking data. When an identical product is not available, firms would be required to demonstrate that they took reasonable steps to identify that the exact same product wasn't available on the market. For example, documentation of the firm's online searches, or confirmation from a manufacturer/distributor that they supplied a product exclusively to the RTO firm. Firms will need to provide this information on request to our supervisors.

Basis for and estimated impact of controlling base prices

4.16 The outcome we want from our proposed cap is to control RTO base prices. Our proposed approach to benchmarking enables RTO firms to set prices within the upper range of genuine market prices. This would not prevent firms from pricing below the level of the benchmark price to be more competitive. We estimate that benchmarking in the way we propose would, on average, bring RTO base prices to within 10% of median retail prices. From our review of the differences in the retail prices of widely sold appliances, technology products, televisions and audio products sold by mainstream retailers we see that the highest price is generally around 10% above the average (in a sample of 10 general retailers). We find an average of 11-12% for technology products and 11-13% for appliances, but only 3% for televisions and audio products.

4.17 We have seen average prices at RTO firms that are 15-56% above median mainstream retail prices, depending on the product category. Bringing these down to 10% above median mainstream prices would mean a reduction in cost of 4% - 30%. We also see products that are at an extremely high level compared to median mainstream prices – around 75% higher. On these products, base prices would need to come down by more than a third.

4.18 The impact the proposed benchmarking will have on firms depends on each firm's current price-setting practices and on the level at which we set the total credit cap.

4.19 The level of the total credit cap matters because firms may raise interest rates to recoup revenue lost from benchmarking ('waterbedding'). The level at which the total credit cap is set limits their ability to do this. We discuss this further below.

Q3: Do you agree with our approach to benchmarking base price?

Total credit cap

4.20 We are proposing a price cap based on the total cost of credit. This may not exceed 100% of fixed allowable costs. Fixed allowable costs are the price of the product and, if chosen by the customer, delivery and installation.

4.21 Under this cap, consumers will not repay more than the price of fixed allowable costs in interest charges. There are other components of RTO pricing which are not included in the total credit cap. We explain our proposals for controlling these prices below.

4.22 We are proposing that for agreements in breach of the total credit cap the obligation to pay all credit charges is unenforceable against the borrower.

Theft and accidental damage cover

4.23 Typically, RTO firms require consumers to hold a valid insurance policy to cover the risk of theft and accidental damage (TAD). Our authorisations work with the sector has led to firms 'unbundling' insurance and offering it as an optional purchase. This is because consumers may be covered by their own home contents insurance or could get alternative cover.

4.24 Most consumers choose to buy TAD cover from RTO firms, which has some features which may be beneficial for consumers using RTO – such as no excess charges if they have to make a claim.

4.25 We have considered whether we should include TAD as a fixed allowable cost and so subject to the same benchmarking requirements as base price. There are, however, practical difficulties for firms in finding directly comparable insurance cover, as the availability of such specific insurance products is limited and it is not always clear whether cover from a third-party would extend to goods subject to hire-purchase. Additionally, because the total credit cap and requirements to benchmark prices will reduce the upper range of total costs, we do not think capping the TAD part of the costs is necessary.

4.26 Instead, we propose a rule to prevent a firm from increasing its TAD charges as a way of getting around the effect of our proposed price cap. If a firm wants to raise its insurance charges, it would need to be able to prove that this is a legitimate business need (e.g. more customers are claiming on their policies) rather than an attempt to recoup revenue lost because of the price cap.

4.27 We will intervene further if this approach does not act as a suitable deterrent to increasing TAD prices.

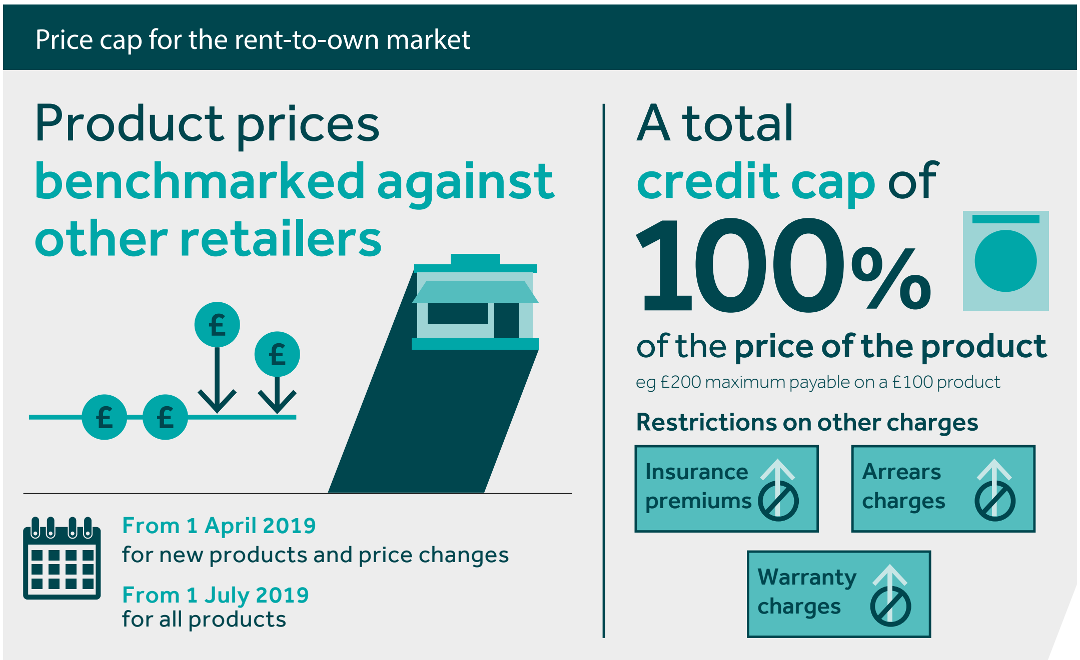
Arrears charges

4.28 When a consumer falls into arrears, the firm will generally charge them for missed payments, or for collections activity that the firm undertakes. The typical arrears charge we find in this market is £10 to 12. Even where a firm caps the number of times a consumer can be charged,[8] they could theoretically be liable for hundreds of pounds in arrears charges over the course of an agreement.

4.29 However, we do not see figures like this in practice. Firms have also responded to the concerns we raised over how they treat consumers in long-term financial difficulty. We recognise that firms need to recover reasonable costs through arrears charges which, for an RTO firm, may include personal contact with the consumer. Our main concern is whether firms will raise their arrears charges in response to the total credit cap. To reduce this risk, we propose a rule to prevent firms from increasing their arrears charges simply to offset the effects of the price cap. Any increase in charges would

8 One large firm limits the accumulation of arrears charges to £48 in a 13-week period.

need to be a justifiable reflection of an increase in the firm's relevant costs.[9] Again, this is an area that we will monitor and we will intervene further if necessary.



Basis for and estimated impact of a total credit cap

4.30 We have used data from individual agreements, and how these agreements perform over time, to simulate the impacts of a total credit cap. The impact of the total credit cap on firms also depends on the proposed benchmarking process. Firms may try to reduce the effects of lower product prices from benchmarking by raising the interest rates on their agreements. To estimate the impact of this waterbedding effect, we assume that firms would raise the interest rate on individual agreements, to the point where they either fully recovered their previous revenue or hit the cost cap.

4.31 Caps substantially below 100% (e.g. 75%), combined with the effects of benchmarking, have a very large effect on firms' revenue. They may seriously affect the availability of RTO credit. Caps substantially above 100% (e.g. 125%) do little to address the harm from the highest prices if firms start increasing interest rates.

4.32 In the range around 100% – caps at 90% or 110% – the effect of the cap on firm revenues does not jump dramatically. For caps between 90% and 110%, combined with the effects of benchmarking, we estimate that firms would stop offering less than 5% of agreements. This relatively low figure is because firms expect individual agreements to make up much of a firms' net revenue. This is because consumers generally pay much more, in total, than the cost of the goods sold. We estimate that most agreements will remain profitable for RTO firms, and so, as long as firms continue to trade, we do not expect a price cap of between 90% – 110% to have a significant impact on consumers being able to access RTO.

9 CONC 7.7.5R

4.33 So, we have focused on setting the cap in the range of 90% to 110%. Caps in this range will reduce the prices consumers pay, without creating a significant risk to the ongoing availability of RTO.

4.34 We consider 100% is a reasonable threshold within this range for the total cost of RTO credit. This takes into account that consumers choosing insurance and extended warranties could pay more than 100% of the base price in interest, insurance premiums, and warranty charges. We consider a cap of this level to be the best balance between reducing the harm we have found and minimising unintended consequences such as reducing consumers' access to RTO.

4.35 The total credit cap is not designed to impact on agreements with lower total costs, which are typically shorter-term agreements. We think it unlikely that firms will raise prices on these shorter-term agreements to offset revenue lost through the price cap on longer-term agreements. If firms consider the profitability of different agreement lengths in isolation of each other, firms already have an incentive to set prices at the most profitable level. If firms instead consider how profitable different agreement lengths are as a whole, we do not think they will have an incentive to raise the prices of shorter-term agreement. This is because this would make longer-term agreements, which have had their revenue reduced by the cap, more attractive to consumers.

Q4: Do you agree with proposals for a total credit cap?

Q5: Do you agree with our proposals on controlling the price of TAD cover?

Q6: Do you agree with our approach to controlling the price of arrears charges?

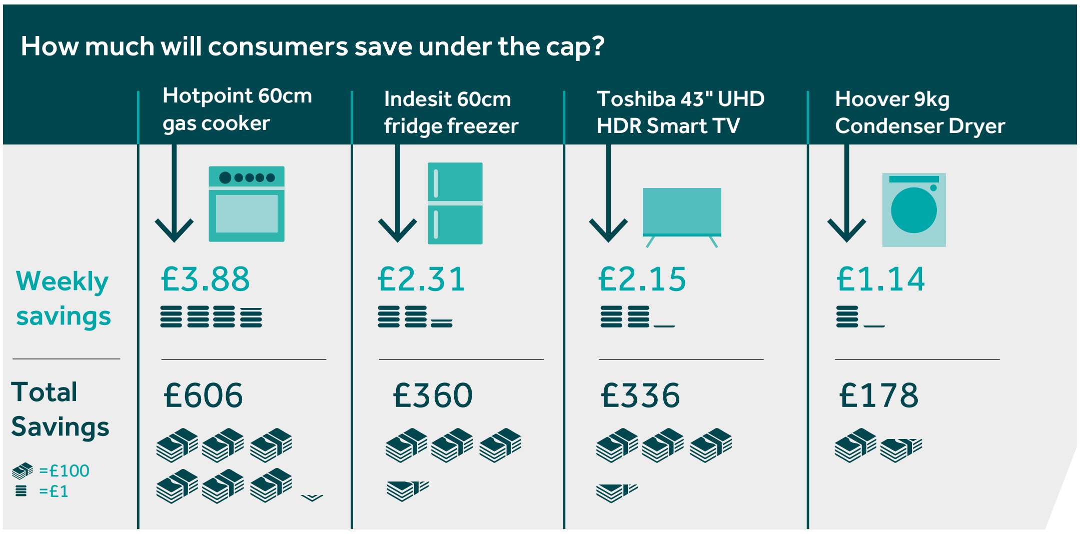
Impacts on consumers

4.36 The proposed level of total credit cap, combined with benchmarking, strikes the right balance between the potential impact on firms and consumers of a smaller RTO market and the benefits to consumers of lower prices. Our assessment is that there will be an overall benefit for consumers from a price cap at this level because some consumers will pay lower prices, and some will make savings from getting goods a cheaper way.

Consumers paying lower prices as a result of the cap

4.37 We estimate that consumers who continue to use RTO will save £17.9m a year as a result of the proposed price cap.

4.38 RTO consumers who currently pay the most, compared to other mainstream retail prices, will benefit the most.



A small proportion of consumers may lose access as a result of the cap

4.39 As described above, we estimate that fewer than 5% of consumers would lose access to RTO under the proposed cap, if all RTO firms keep trading. If an RTO firm ceased trading this would clearly reduce access to RTO further. At the extreme, this could stop RTO firms operating entirely. Our analysis suggests that this is an unlikely outcome. If it were to occur, this could be a worse outcome for some consumers who would otherwise use RTO and it is important that we fully consider the risks and potential impacts.

4.40 Based on our survey of rejected RTO applicants, we would expect up to half of any consumers who would lose access as a result of a cap to go without the goods they wanted. While some would benefit from avoiding RTO, some of these consumers will consider that some of these goods were essential and will find it uncomfortable to go without them. 57% of those declined applicants who responded to our survey and went without the white goods they were seeking said that this had made their life more difficult. However, of those who went without technology products because their application for RTO was declined, only 22% said this had made their life more difficult, while 42% said there were no consequences.

4.41 For those consumers who manage to obtain the goods by other means, we expect most to use cash and so pay less. However, the trade-offs that these consumers need to make, such as using cash that would otherwise go to cover other important needs, could come with negative consequences.

4.42 Most consumers who lose access to RTO are unlikely to be able to access other forms of credit. We estimate that 19% to 24% of RTO consumers could have got enough new credit elsewhere to finance the RTO purchase. In our survey, 15% of declined applicants who bought the product elsewhere used credit.

4.43 Consumer may be able to get financial help from friends and family, although this is not always possible. About 10% of declined RTO applicants in our survey who ended up buying the product elsewhere said that they borrowed from friends and family to do so.

4.44 RTO applicants don't appear to seriously consider using illegal money lenders. None of our survey respondents reported using a loan shark instead of using RTO, and less than 1% considered it.

4.45 Credit unions and community development financial institutions (CDFI) will be a viable alternative for some. However, these have traditionally been small scale and/or limited to particular geographic areas.

4.46 We expect the work we are doing on alternatives to high cost credit to have some impact in helping consumers to get essential goods. But these are longer term solutions and some consumers will suffer negative consequences as a result of the price cap. However, our estimates suggest that this will be a small proportion of RTO consumers.

4.47 We set out our full cost benefit analysis, detailing the effects of the price cap proposals on firms and consumers, in Annex 2.

Other effects of a price cap: consumer hire

4.48 A potential impact of the price cap is that firms move to consumer hire rather than an RTO model. Our proposals only apply to RTO.

4.49 Hiring household goods to consumers is a regulated activity and owners (hirers) must comply with relevant provisions of the Consumer Credit Act and with relevant CONC rules.[10] However, firms do not need to carry out an affordability assessment before entering into a consumer hire agreement.

4.50 Unlike with RTO, a hire contract does not result in the consumer owning the goods at any time. Firms operating consumer hire have different disclosures, can charge no APR and consumers can be tied in for a minimum of 18 months. Apart from this, the product range, target market and high prices of some consumer hire firms can be very similar to RTO firms. We are also aware of some hire companies that use consumer agreements for some household goods that includes a clause allowing the consumer to gift the product to a third party. Other hire firms may simply leave the goods with the consumer at the end of the term.

4.51 We have concerns about consumer hire agreements that have similar features and pricing to RTO agreements. We will consider carrying out further work so that we better understand the risks and costs to consumers of these agreements, and will intervene to protect consumers if necessary.

10 The agreement would only be regulated if it is capable of exceeding 3 months.

How we define what is an RTO agreement

4.52 In CP18/12, we consulted on a definition of an RTO agreement. This covers hire-purchase or conditional sale agreements that require consumers to make repayments more frequently than monthly. It excludes motor finance or goods bought for business purposes. As set out in Chapter 5, we are using this definition for our proposals on extended warranties.

4.53 However, for the purposes of our proposed price cap, we are putting forward a separate definition of an RTO firm. This would cover firms that enter into hire-purchase or conditional sale agreements (of any repayment schedule), which offer a range of household goods. The frequency of payments is not part of this definition.

4.54 We are consulting on this different definition. This is in part because there is a risk that a firm entering into 'RTO agreements' – as defined for our extended warranties proposals – might move to a monthly repayment model to avoid being caught by a price cap. The definition also distinguishes RTO firms from firms who offer hire-purchase for a narrow range of specialist products such as musical instruments. The definition of RTO for the purpose of the extended warranty rules did not need to make this distinction because our research shows these firms do not offer extended warranties.

Implementation timetable

4.55 If we introduce a price cap as proposed, the rules would take effect on 1 April 2019. They would apply to products sold by RTO firms in the following ways:

- For products that RTO firms begin selling for the first time on or after 1 April, the rules would apply immediately;
- For existing product lines, the rules would apply as soon as an RTO firm changes the price of a product. If there are no price changes, the rules will apply from 1 July 2019.

4.56 Firms will therefore have to bring their existing products into line with the new rules by no later than 1 July 2019.

4.57 We believe this strikes the right balance between ensuring the cap is implemented promptly in order that consumers can start benefiting and giving firms enough time to adjust to the new regime.

Q7: Do you have any views on the implementation timetable?

5 Feedback on consultation on extended warranty proposals

Introduction

5.1 In CP18/12 we consulted on measures for the sale of extended warranties. We proposed the following additional consumer protections:

- A point of sale ban on extended warranties sold alongside the RTO agreement. This would require firms to allow two clear days before consumers can buy an extended warranty
- New requirements on firms to give consumers extra information to help them decide whether to buy the extended warranty. This information would include the price in terms of weekly, annual and length-of-contract cost, as well as how the extended warranty works with the manufacturer's warranty and any theft and accidental damage (TAD) insurance.

5.2 These measures are intended to reduce the harm to consumers from the high costs of using RTO, as well as our wider measures on pricing. Payments for extended warranties are typically around 10% to 20% of a consumer's weekly RTO payments, and approximately 70% of consumers buy them.

5.3 We found that consumers were sometimes unclear about the value of warranties and that the products represented limited value where manufacturers warranties were still in place (usually at least the first year after the contract was formed).[11] Firms have a significant point of sale advantage in selling warranties at a time when consumers main focus is on getting household goods that may be essentials.

5.4 While we noted that extended warranties may provide some benefits to consumers in terms of quality of service (faster repairs, convenience) our proposals aimed to address harm by reducing unnecessary purchases.

Summary of feedback and our response

5.5 This chapter summarises the responses we received to the consultation and our response. We received 22 responses to this part of the consultation, representing a wide range of views from industry and consumer groups.

5.6 Overall, respondents largely supported our proposals, so we are proceeding with the draft rules on the basis on which we consulted. However, firms gave us new information on costs during the consultation period and we have taken them into account.

11 Under manufacturers warranties consumers are generally entitled to repairs and replacement products at no additional cost to the consumer, and consumers have standard rights to repairs or returns under the Consumer Rights Act 2015.

5.7 We also propose excluding extended warranties from our proposed price cap. By ensuring consumers can make a more measured and informed decision about whether these warranties give them value or not, we will address harm from the inappropriate purchase of extended warranties.

5.8 We set out the final rules and guidance in Appendix 2. These rules come into force on 22 February 2019. Firms affected by these changes will need to ensure they comply by these dates.

Q1: ***Do you agree with our proposals for a point of sale ban on extended warranties?***

Feedback

5.9 Consumer organisations largely welcomed the proposed measures, with many reporting that consumers feel they have to buy add-ons or are confused about the product. However, some asked us to go further with our proposals. Many questioned the value of extended warranties. These respondents suggested that we ban their sale outright where consumers are otherwise protected by manufacturers warranties or consumer rights legislation.

5.10 Firms had expressed a number of concerns about our proposals. One industry respondent argued the intervention is 'not proportionate, necessary or justified'. They pointed to the service-level agreements and accessibility which make extended warranties 'significantly superior' to manufacturers warranties. They also provided evidence from consumer survey results and claims rates that consumers place high value on the product.

5.11 On claims rates, one firm reported that the 40% ratio (£4 paid out in claims for every £10 paid in premiums) we gave in CP18/12 is understated. This is because firms carry out their own product repairs, rather than outsourcing to third parties which they argue would be more expensive. They suggested that using wholesale prices would give a substantially higher claims ratio and which is relatively high when compared with rates for other products where deferred sales interventions have been introduced previously (e.g. GAP had a claims ratio of 10%, and PPI had 20%).

5.12 One RTO firm argued that it is inconsistent or anti-competitive for us to intervene only on warranties sold by RTO firms, and not extended warranties marketed more generally.

5.13 Another firm agreed with the proposals but argued that the point of sale ban should not apply to online sales. This is because online sales give firms less opportunity for pressure selling and consumers have more time to consider whether to buy warranties.

5.14 Other firms argued that our proposed requirements for more consumer information are enough to allow consumers to make informed choices, and that consumers could be left exposed if a product fails because of the proposal and they do not have an extended warranty.

5.15 One firm asked if the proposals extend to warranties provided to the consumer for free.

Our response

5.16 We do not agree with the suggestion to ban RTO firms from selling extended warranties. We recognise that extended warranties can provide some extra benefits to consumers, over and above a manufacturer's warranty, if a product has a fault. These benefits can include a commitment to faster repairs, replacement products and no fees charged where no faults are found. However, we do not have data on actual repair times for extended warranties compared with manufacturers warranties.

5.17 Firms have also provided evidence, such as consumer surveys, to suggest that some consumers value the security they get from their service package. This is particularly the case on essential goods which the consumer would otherwise find difficult to replace. Our own consumer survey suggests that the availability of add-ons is not a key driver for using RTO. We are of the view that our proposals strike the right balance between allowing those consumers to continue to buy extended warranties and addressing the point of sale advantage that firms have. This helps consumers understand more about the product and whether it's right for them, and some consumers who choose not to buy are likely to save money as a result.[12]

5.18 We would stress that under the new rules firms have some flexibility in designing their extended warranty sales process. The rules would specify a minimum of two clear days, but no maximum, before the consumer can decide to buy an extended warranty. This means that if consumers decide these products have value to them there is nothing in the rules to stop them buying them at a later time.

5.19 On claims ratios, we recognise that consumers may get some benefit from extended warranties and this is reflected in the claims rates industry respondents provided.[13] However, we would highlight that claims ratios are less meaningful where the consumer does not receive a cash payment. We also have no reason to believe that RTO firms are more efficient at repairs than alternative providers and have seen no evidence to suggest this. We also question whether some consumers who claimed against their extended warranty could have claimed against a manufacturer's warranty if in place.[14] We note that any incidence of accidental damage would require consumers to claim against the separate TAD cover.

5.20 We do not agree that this measure is anti-competitive in that it introduces measures only for RTO firms selling extended warranties and not others. We are acting here due to the specific harm caused to consumers using RTO (who are typically financially vulnerable) from the high prices they pay in the sector. This remedy is in fact pro-competitive as it addresses the point of sale advantage held by RTO firms in selling insurance products alongside credit agreements. Although we anticipate that some consumers won't buy extended warranties at all, others may decide to buy them from other firms that do not have this point of sale advantage.

5.21 Our rules apply to both in-store and online sales. Although there may be less pressure online than in person, firms still have a point-of-sale advantage.

5.22 Our proposals only concern warranties subject to direct monetary consideration.

12 Our recent evaluation of the GAP remedy shows the impact that point of sale bans can have in encouraging consumers to reconsider purchases or shop around https://www.fca.org.uk/publications/corporate-documents/evaluation-guaranteed-asset-protection-insurance-intervention

13 Note that the OFT found in 2012 that claims ratios for extended warranties stood at around 50%, although it appears that many of the products in question included accidental damage cover (sold separately by RTO firms).

14 We have received only partial data from firms on when warranties claims were made, but from data one firm indicates that a significant proportion were made while manufacturers warranties were in place.

Q2: ***Is the two day deferral period the right length of time?***

Feedback

5.23 Several respondents argued that we should require a longer deferral period after the disclosures are given, with suggestions ranging from seven days to a month. However, industry respondents argued that this is the maximum 'break' possible that won't cause significant disruption to consumers and sales processes.

Our response

5.24 We believe that the two clear day deferral period gives a sufficiently long break to remove the point of sale advantage while minimising disruption in the sales process for those who wish to buy extended warranties. We also believe that two clear days is an adequate amount of time for consumers to consider the purchase of extended warranties including the information given at the point of sale.

Q3: ***Do you have any comments on the proposal to provide adequate explanations to enable the consumer to make an informed decision?***

Feedback

5.25 Two firms argued that there are measures already in place to reduce the point of sale advantage, evidencing their disclosure materials and the requirements for disclosure under the Supply of Extended Warranties on Domestic Electrical Goods Order 2005. They requested clarification on how our new requirements interact with existing standards.

5.26 Some consumer groups suggested that we require firms to signpost to alternative providers or the price comparison website for extended warranties.[15]

5.27 A number of respondents stressed that the information required must be presented to consumers in a way that is straightforward for them to understand.

Our response

5.28 In the cost benefit analysis for CP18/12, we noted that firms must provide consumers with certain information under the Supply of Enhanced Warranties on Domestic Electrical Goods Order 2005. We also noted that firms already provide consumers with some of the information required for certain products. Our proposed information requirements will extend this to warranties for all products provided by RTO firms, not just domestic electrical goods. Our requirements also mean RTO firms must provide information of specific relevance to RTO consumers such as the cost of the warranty over the term of the agreement.

5.29 We do not expect firms to duplicate the information they give consumers. We expect firms to consider how to satisfy both our new rules and the requirements of the Supply of Enhanced Warranties on Domestic Electric Goods Order 2005.

5.30 Firms selling domestic electrical goods are already required to signpost to the price-comparison website for extended warranties. We are not proposing to extend this to other types of products which are not domestic electrical goods, for example furniture, as the comparison website only features extended warranties for electrical products.

15 http://www.compareextendedwarranties.co.uk/

5.31 The rules we consulted on require firms to give the required information at the same time it offers to sell an extended warranty, and in the same document. This information must be communicated in a way that is clear, fair and not misleading in writing or another durable medium. It must be made available and accessible to the consumer, and the firm should draw the consumer's attention to the information.

Q4: ***Do you have any comments on our proposed definition of RTO?***

Feedback

5.32 We only received a handful of responses to this question. Some consumer groups argued that we should not limit the definition to models where customers have to repay more frequently than once a month. Some firms offering goods on hire-purchase argued that they shouldn't meet the definition due to differences in their business model and charging structure.

Our response

5.33 We consider our definition to be appropriate for the purposes of our rules on the sale of extended warranties. As set out in Chapter 4, we are putting forward a separate definition of an RTO firm for our proposed price cap. This would cover firms that enter into hire-purchase or conditional sale agreements (of any repayment schedule), and that offer a range of household goods.

Q5: ***Do you have any comments on the proposed period for firms to implement the new rules?***

Feedback

5.34 All respondents who answered this question were in favour except for one firm who argued that it could take up to six months to bed in the changes.

Our response

5.35 We are allowing firms three months to adopt to these rules, from 22 February 2019. We consider that there are a range of ways in which firms could choose to comply with the new requirement. We advise that firms make any systems and personnel changes in a way that allows them to meet this timing.

Comments on CBA

5.36 One firm also argued that the CBA on these proposals published in CP18/12 concerning overstates the benefits to consumers and understates costs to firms. They argued that:

- They would incur one-off costs totalling £260K as a result of setting up a centralised sales team and amending IT systems to enable post-sale addition of extended warranties to contracts. This was in addition to the IT costs for providing additional information to consumers, which were included in the original CBA.
- They would need a dedicated sales team of 60 staff to follow up on every agreement with consumers, amounting to a cost of £2.6m per year.
- The fixed costs for servicing warranties mean that their reduction in profit would not be proportionate to the reduction in sales of warranties. The firm reported that there are significant fixed costs from running its repair network, for example through central repair facilities, regional facilities and field engineering teams.

- That the losses to consumers of lack of coverage are greater than estimated, as repairs carried out under extended warranty are cheaper than repairs on the open market.

5.37 If we were to include all of these additional reported costs then this would affect the proportionality of the CBA, as follows:

- One-off costs of compliance, mainly in relation to training staff would increase by £0.26m to £0.9m-£1.2m.
- Additional ongoing costs would increase from zero to £2.6m per year.

5.38 In addition, the second two bullets on fixed costs and loss of coverage would impact our CBA figures for the reduction in profits to RTO firms (which we said was £2.5m-£7m per year) and net savings to consumers (which we said were £3m-£7.7m per year). However, the firm was unable to provide a clear estimate for the impact of the effects on these two components of the CBA.

5.39 We have considered each of these claimed costs and comments in detail below.

5.40 We agree there may be some additional one-off IT costs from setting up a new sales process with IT support to enable the sale of extended warranties post-sale. We note that it is already possible to buy extended warranties from this firm after the RTO agreement has been entered into. Including this additional one-off cost does not materially change our CBA.

5.41 We agree that firms will incur some additional costs from selling extended warranties under the point-of-sale ban. However, we do not expect the costs of selling extended warranties to be as large as the firm suggests for the following reasons:

- If firms undertake similar activity within store as before the point of sales ban, only completing the warranty sale needs to be done after two clear days. This would be most likely to only apply to those consumers that said they were interested at the point of sale. Only around 60% -70% of consumers took out these products, so it is unlikely that the firm would need to follow up on every consumer. In contrast, the firm assumed that every purchase would need a follow up telephone call.
- There will also be some time cost savings from in-store staff, as they cannot complete the sale of extended warranties at the point when consumers buy the RTO product and these staff can undertake other activities. This cost saving should be offset against any increased costs from selling extended warranties after the point of sale.
- This time cost would be limited because firms would not require a significant amount of time to conclude sales. Indeed, we expect firms would develop low cost ways to finalise sales using technology.
- Firms have many touch points with consumers. These could be used to sell extended warranties after the two-day ban period that may be fairly low cost.

5.42 For these reasons, we do not think the extra costs from selling extended warranties will be as large as £2.6m; it is more likely to be significantly less. We have assumed that the additional costs of selling extended warranties are £1.3m, or 50% of the cost the firm reported. We believe this is the upper limit of the potential costs.

5.43 How much a firm's profit reduces after our intervention depends on how far its existing servicing costs are fixed or variable. In our CBA, we assumed that all the costs were variable, but the firm has argued that there are significant fixed costs. If all the costs of servicing warranties were fixed then the costs to firms in terms of lost profits would be exactly equal to the loss of revenue – there would be no additional cost savings. However, we expect at least some of firms' costs for providing extended warranties will be variable. For example, there will be some variable costs from visiting consumer's houses or the costs of materials used in fixing products.

5.44 So, we wanted to understand what the appropriate split might be for fixed and variable costs and how any reduction in volumes would affect variable costs. However, when clarifying the fixed cost estimate it had provided, the firm told us that the figures included both variable and fixed costs but did not split these out or explain the relationship between volume and variable costs. So, we are unable to estimate the precise split between fixed and variable costs, nor how far any reduction in volumes would lead to a proportionately smaller reduction in costs than in revenues.

5.45 We still consider that many of the repair costs are ultimately variable. This is because, in response to decreases in volume, some of the engineering teams can be reduced and regional repair centres can be closed and some services potentially outsourced.

5.46 However, as we expect some of the firm's costs are fixed, at least in the short run, we have used the assumption that 50% of the costs are fixed to create an upper bound for loss of profits. In practice, we would expect a much smaller proportion of costs are fixed but we take a conservative approach in our updated estimates.

5.47 On the relative efficiency of RTO firms when making repairs, the information the firm provided compared the cost of repairs with retail prices for repairs. This is not a like-for-like comparison as retail prices will include fixed costs allocations and profits that the firm's information did not account for. We have no reason to believe that RTO firms are more efficient than alternative providers of repairs and have seen no evidence to suggest this. As a result, if consumers get their products repaired elsewhere then the costs of this may be similar.

5.48 We used the costs firm provided as a proxy for the costs to consumers of repairing their product if their product broke down. We also took a conservative approach to the costs to consumers. We assumed coverage lasted 3 years and so consumers were not covered for 2 years if they did not buy an extended warranty. In reality, agreements are on average less than 3 years long. Consumers will therefore generally be covered by manufacturers' warranties for a greater part of their RTO agreements than our CBA estimated.

5.49 We do not therefore think we have underestimated the costs of a lack of cover and have kept the estimates in our original CBA.

5.50 The following table sets out our updated analysis, taking into account the responses provided by the firm, alongside the estimates we provided in the CBA we published alongside our Consultation Paper.[16]

Figure 1: Summary of the changes of the CBA

	Original CBA in Consultation Paper	Updated CBA
Costs	Firms (one-off costs): Updating systems – £20,000-£40,000 Training – £0.6m-£0.9m Familiarisation – Minimal Reviewing and updating information to consumers – £25,000-£50,000 Total £0.65-£1.0m Firms (ongoing costs): Reduction in profits – £2.5m-£7.0m Total – £2.5-7.0m Consumers (ongoing costs) Loss of extended warranty benefits – £1.0-1.3m	Firms (one-off costs): Updating systems – £280,000-£300,000 Training – £0.6m-£0.9m Familiarisation – Minimal Reviewing and updating information to consumers – £25,000-£50,000 Total £0.9-£1.3m Firms (ongoing costs): Reduction in profits – £2.5m-£8.0m New sales team – £1.3m Total – £3.8-9.3m Consumers (ongoing costs) Loss of extended warranty benefits – £1.0-1.3m
Benefits	Consumers savings on extended warranties – £4.0-9.0m	Consumers savings on extended warranties – £3.0-8.3m

5.51 Because we have taken a conservative approach to estimating the costs, the ongoing costs are slightly larger than the ongoing benefits and so the proposals do not appear proportionate. However, we believe that our proposals are proportionate for two reasons. Consumers using RTO are some of the most vulnerable in society. Our view is that benefits to these consumers should be weighted more highly than costs and benefits to firms and other consumers. This mirrors our approach in the CBA for the price cap. Secondly, our prudent approach to costs provides a worst-case view of the impact of our proposals. We expect the proposals to provide greater net benefits than the table above indicates.

Interaction with price cap

5.52 When considering whether to take forward our warranty proposals we re-examined their impact in the light of our developing proposals on a RTO price cap. This is particularly important in evaluating the overall impact on firms and consumers of all our interventions in the RTO sector for the CBA.

5.53 We believe that the most proportionate approach would be to exclude extended warranties from the proposed price cap. The harm from extended warranty sales is that consumers buy them without fully understanding the product they are getting. This means they may spend money on a product which may not hold value for them. The point of sale ban targets this harm by allowing consumers to make more informed, and unpressured, decisions about whether to buy a warranty. Consumers who decide

16 We note that in our CBA we used an assumption that sales of extended warranties would fall by 10-20%. This range was informed by our findings in 'An evaluation of our guaranteed asset protection insurance intervention' (see https://www.fca.org.uk/publications/corporate-documents/evaluation-guaranteed-asset-protection-insurance-intervention) that was at the time unpublished. The range used was at the bottom end of the impact we saw in this evaluation. This is in line with our general approach to conservatively estimate costs and benefits. We continue to use this range in our updated analysis.

not to buy one can reduce their weekly repayments by around 20%, which can be significant over the course of a 1 to 3-year agreement. When coupled with a price cap affecting base price, credit and insurance costs many consumers using RTO will pay substantially less.

5.54 We have included the impact of our extended warranties proposals when calculating the price cap and carrying out the CBA to ensure we have considered the impact on firms and consumers.

6 Alternatives to high-cost credit

6.1 In CP18/12 we explained the key barriers we have identified to the access to alternatives to high-cost credit, and to the further development of such alternatives. We set out a number of areas where we believe action could be particularly helpful in promoting access to alternatives.

6.2 In this chapter, we:

- explain why promoting the availability and awareness of alternatives to high-cost credit is a key aspect of our work on RTO and other high-cost credit products
- summarise respondents' feedback to our work on alternatives which we set out in CP18/12, and respond to suggestions made
- give updates on the various aspects of our work on alternatives, including our engagement with stakeholders

Summary

6.3 We summarise below our approach to alternatives and how we are working to tackle the barriers to availability and awareness.

Alternatives to high-cost credit: our approach

What are the issues we want to address?

Consumers who can't access mainstream credit are using expensive high-cost credit products

Our interventions may reduce the availability of high-cost credit for some consumers

Why are consumers not using lower cost alternatives to high-cost credit?

There is limited availability of alternatives

Consumers have limited awareness of alternatives

So we are aiming to increase availability and awareness of:

Lower cost credit

Alternatives to credit that meet consumers' needs

How are we doing this?

1 By taking action on issues we are best placed to address, eg

- providing guidance to social housing landlords to help them understand regulation on credit broking
- reducing FCA fees for community finance organisations and credit unions

2 By working closely with Government, the private sector and the not-for-profit sector to deliver change by

- providing expertise
- supporting initiatives to promote alternatives, eg Government's work towards a no-interest loans scheme, the Financial Inclusion Policy Forum

3 By bringing organisations together to develop effective approaches, including

- working with firms on new business models and products
- holding a forum for housing associations and providers of household goods to see how they can work together to improve consumers' access to goods

6.4 Table 6.1 summarises the further actions we will take. These are discussed in this chapter.

Table 6.1: Summary of further actions on alternatives to high-cost credit

Action	Paragraph in chapter
Engage with credit unions and Community Development Finance Institutions to help them understand how FCA Innovate, especially the Regulatory Sandbox, may be able to help them	6.49
Report on our event taking place in November 2018 which brings together housing associations and providers of household goods	6.50
Consider whether there is a need for more information about credit options to be made available online, and where it might be best placed	6.51
Consider the appropriateness of requiring firms to signpost consumers to lower cost credit and other sources of support when rejecting loan applications	6.53
Work with HM Treasury to identify the appropriate scope of legislation amending the regulatory boundary for credit broking by Registered Social Landlords	6.61
Finalise and publish FCA Guidance for Registered Social Landlords on which we consulted in May 2018	6.64
Consider responses to CP18/34 on FCA regulated fees and levies for 2019/2020 with regard to exempting community finance organisations and credit unions from paying all FCA consumer credit fees and, if appropriate, finalise the proposed rules	6.65 to 6.69
Consider as part of our market study on Credit Reference Agencies the issues affecting the coverage and timeliness of credit information for lower cost credit providers	6.70 to 6.75
Continue to work with relevant Government departments and other entities on initiatives promoting access to alternatives to high-cost credit	6.85 to 6.113

Alternatives as a key aspect of our work on high-cost credit

6.5 In this section, we set out why alternatives form an important part of our work on high-cost credit, and summarise our approach.

Our approach

6.6 Three million[17] consumers use high-cost credit in the UK, some of whom are among the most vulnerable in society. Many have low credit scores and low incomes, so often cannot access mainstream forms of credit. A growing segment of the UK population are employed on zero-hours contracts or in the 'gig economy', which may mean they have unstable or unpredictable incomes. For many recipients of state benefits, the transition to Universal Credit is leading to changes in the way they receive and manage their money.

6.7 For these and other consumers, income shortfalls, unexpected expenses and/or limited access to mainstream credit can lead to the use of high-cost credit products. Their higher risk to lenders can contribute to the higher cost of this credit.

6.8 These consumers would pay less if they were able to use alternative, lower cost forms of credit instead. We use the term 'lower cost credit' in this chapter to refer to

17 This figure does not include the use of overdrafts.

credit that is lower in cost than the credit typically available to these consumers from high-cost credit providers.

6.9 As we set out in Chapter 4, we estimate that the proposed RTO price cap would leave fewer than 5% of RTO customers unable to access RTO. About half of these, approximately 2.5% of all RTO customers, would be unable to access the goods using either cash or credit. The interventions we proposed in CP18/12 and CP18/13[18] in other high-cost credit markets might also reduce the availability of credit for some customers. We have therefore considered how customers could be helped to access alternatives that produce good outcomes for them.

6.10 While there may be alternatives to high-cost credit for these customer groups, there are barriers to their access. In summary, these are:

- limited availability of alternatives (supply side)
- limited consumer awareness of alternatives (demand side)

6.11 To address these barriers, we believe it is necessary to consider two different types of alternatives:

- sources of lower cost credit, for example credit unions and Community Development Finance Institutions (CDFIs), sometimes called 'social lenders' or providers of 'responsible finance'
- alternatives to credit which meet the consumer's underlying need, for example sources of essential household goods, debt advice, or budgeting help

6.12 Our approach includes alternatives to credit because some consumers' needs may not always be best met by providing credit; this may be harmful for some. We want to see an increase in the options available to consumers as well as in their awareness of these non-credit alternatives, so that they can make more informed choices. This makes it more likely that consumers will make choices that lead to better outcomes.

6.13 We recognise that many consumers would benefit from better access to alternatives immediately. At the same time, the complexity of the issues means that no one solution or single package of measures can ensure everyone has access to lower cost credit or an appropriate alternative. This means our expectations of change must be realistic.

6.14 We expect there will be progress in the coming months and years, but that it will be gradual. All relevant stakeholders will need to make consistent efforts over a long period. In this way, change can be effected little by little, and momentum may be created. We are committed to playing our part in this.

6.15 As we acknowledged in CP18/12, the FCA cannot address all the issues around barriers to availability and awareness of alternatives. They are not all within our remit. These issues are in any case too diverse and too complex for any single organisation to tackle. We are committed to:

- taking action on the issues that we are best placed to address

18 High-cost Credit Review: Overdrafts, May 2018 – https://www.fca.org.uk/publication/consultation/cp18-13.pdf

- working closely with other relevant stakeholders, including the Government, public agencies, the private sector and the not-for-profit sector, to deliver change, provide expertise and support initiatives that promote alternatives to high-cost credit

- bringing stakeholders together to develop and coordinate effective approaches to promoting alternatives

6.16 Later in this chapter we set out the actions we have taken and are considering taking in these areas.

Availability of lower cost credit

6.17 At present, the main providers of alternative, lower cost credit for higher risk consumers are credit unions and CDFIs.

Credit unions

6.18 Credit unions are mutual societies which take deposits from and make loans to their members. They have to demonstrate a common bond between their members, for example working in a particular industry or living in a defined geographical area. Although this has the effect of limiting the number of credit unions an individual is eligible to join, there are over 400 credit unions spread throughout the UK.

6.19 For the protection of their members, legislation sets a lending interest rate cap for credit unions. Lending is capped at 3% per month (approximately 42.6% APR) in England, Wales and Scotland, and at 1% (around 12.9% APR) in Northern Ireland. This makes credit union loans cheaper alternatives to high-cost credit. While some of the larger credit unions have broadened their lending bases to include higher risk consumers, others do not feel able to do so within the cap, or do not wish to for business reasons.

Community Development Finance Institutions (CDFIs)

6.20 CDFIs are not-for-profit consumer credit lenders, established for social purposes to provide credit to low-income consumers. The cost of credit offered by CDFIs is generally lower than that of mainstream commercial credit providers serving this consumer segment.

6.21 However, there are currently fewer than a dozen personal lending CDFIs. Some now operate an online and/or telephone service, which has opened up their loans to consumers living outside of their immediate geographical location. A key challenge for CDFIs is to demonstrate to and be perceived by the wider market as viable and self-sustaining businesses. This is crucial in order to attract the investment they need if they are to expand their operations and reach.

Other potential lenders

6.22 While credit unions and CDFIs are important sources of lower cost credit, the limitations set out above indicate that not all high-cost credit users may have access to these alternatives.

6.23 These and other key barriers we have identified to the availability of lower cost credit[19] are the consequences of existing market structures, legislative or regulatory requirements and, in some cases, practical realities. Consumer behaviour is also

19 See CP18/12, May 2018, paragraph 5.6 – https://www.fca.org.uk/publication/consultation/cp18-12.pdf

relevant, and this includes both individual and collective attitudes to credit. For these reasons, there is no simple way to 'fill the gap'.

6.24 Nevertheless, it is important to focus not only on increasing the availability of credit from credit unions and CDFIs but also on how best to encourage new market entrants. These could be newly established providers or existing firms choosing to expand their product range to offer small, short-term loans to higher risk customers.

Availability of alternatives to credit

6.25 The demand for credit is driven by a complex mixture of economic, social and personal factors. While we believe that credit can have a socially valuable function,[20] we also consider that it is not always the appropriate solution for every consumer.

6.26 By seeking to understand the needs underlying an individual's request for credit, we are asking the question whether non-credit options may be more appropriate. In some instances, the consumer may benefit more in the mid- to long-term from budgeting help, debt advice, or non-financial services such as medical care, counselling or addiction services.

6.27 We recognise that these considerations are closely related to matters of social policy, and that it would not be appropriate for us to comment on past or present government policy in this regard. However, we do see merit in aiming to increase the availability and awareness of both lower cost credit and alternatives to credit, where these meet our strategic and consumer protection objectives. Where consumers can be particularly vulnerable, this can include looking for ways to prevent harm arising due to a real or perceived lack of options.

6.28 For some consumers, the need for credit is driven by the need for essential household goods, such as a fridge, washing machine or bed. This means that other ways of acquiring these goods may be suitable alternatives to credit.

6.29 We have seen many examples of businesses which hire furniture and white goods to consumers, often with extra services like delivery and repairs. These may offer an appropriate alternative for some consumers. There are also many small, local initiatives that accept donations of unwanted household items from the public which they then sell at low cost or donate to other consumers, often exclusively to those on low incomes.

6.30 A variety of different organisations run these kinds of alternatives. Some are profit-making businesses, some are offered by local councils, and others operate on a not-for-profit basis and rely on the support of volunteers. Many have been set up by individuals, community groups or local charities in response to a social need they have seen or experienced in their communities.

6.31 This means that many of these alternative providers of goods are local and operate on a small scale with limited resources. Their success is based on their understanding of local needs, and the relationships and informal collaboration that exist within the community. As a result, they are not easily scalable.

20 See High-cost Credit Review – update, January 2018, paragraph 3.7 – https://www.fca.org.uk/publication/feedback/high-cost-credit-review-update.pdf

6.32 There are many successful initiatives that make a real difference to people's lives by providing essential goods without the need for credit. We are keen to contribute to the sharing of good practice examples so that all kinds of local initiatives can learn from others' experience and go on to develop their own successful approaches.[21] We hope this will encourage the development of alternatives to high-cost credit in more communities across the UK.

Awareness of alternatives to high-cost credit

6.33 There is low public awareness of alternatives such as credit unions, CDFIs and the credit products they offer. This issue should be addressed alongside the limited availability. We consider that the focus in this area should be on how best to improve consumer outcomes. The key question when seeking to increase awareness of alternatives is how best to inform consumers about the available options.

6.34 A potential target for awareness-raising measures could be consumers who are looking for or considering a loan, or are likely to take one out in the near future. Lower cost credit providers may have smaller advertising and marketing budgets than commercial lenders. Where this is the case, it is necessary to consider other ways to reach these consumers.

6.35 Examples might include:

- finding ways to make lower cost credit providers more visible on price comparison websites, as they are currently underrepresented
- online portals devoted to searches for lower cost credit do exist, but without greater public awareness they are themselves under-used

6.36 An effective way to make consumers aware of alternatives is using referrals from one organisation to another as an integral part of a multi-agency approach to credit, debt and social services. Referrals can be informal, for example suggesting during a conversation that the consumer contacts a type of organisation ('you might find it helpful to visit a debt advice charity') or a specific one ('have you tried Lower Cost Credit Provider X located opposite the petrol station?'). Organisations may provide contact details such as a website address or telephone number, perhaps on a leaflet or through an email link.

6.37 Referrals can also be more formal, for example when one organisation requests an appointment with another organisation on behalf of a consumer because they have identified a specific need.[22]

6.38 Referrals are often part of partnerships, networks and other forms of cooperation between public, private and charitable organisations, usually within a defined geographical area. We consider this to be a particularly effective way of both making consumers aware of options they had not previously considered and also of ensuring their individual needs are identified.

6.39 In CP18/12 we suggested that social landlords, such as housing associations, could play an important and wider role in directing their tenants to both lower cost credit and

21 An example of how we are doing this can be found below, paragraph 6.50.

22 An organisation that refers a consumer in any of these ways to a credit provider, provider of goods on hire or credit broker is likely to be engaging in the regulated activity of credit broking. Where this is the case, the organisation must be authorised for the activity by the FCA. This is not usually a long or difficult process, and we can provide help and support.

sources of essential household goods. Social landlords are a particularly good example of organisations that have ongoing relationships with many consumers who may benefit if they were more aware of alternatives to high-cost credit.

6.40 Other types of organisations may also be well-placed to refer their clients in this way. These could be organisations working with specific groups of consumers, for example providing support during pregnancy or helping students to plan for life after graduation. Alternatively, they could be organisations that have relationships with large numbers of individuals, for example large employers.

Summary of feedback to CP18/12 and our responses

6.41 In Chapter 5 of CP18/12, we gave an update on our work on alternatives to high-cost credit and consulted on draft guidance for Registered Social Landlords (RSLs). Although we did not include a consultation question on our approach to alternatives, we are pleased that 13 stakeholders took the opportunity to provide us with comments and suggestions.

6.42 In this section, we summarise the feedback and respond to the specific suggestions we received.

Summary of general feedback and our response

6.43 Comments on our approach to alternatives were made mainly by credit unions, CDFIs (and their representative bodies), consumer groups, and other organisations researching and seeking to inform debates around financial inclusion.

6.44 Most were very positive about our interest and involvement in promoting alternatives to high-cost credit. They highlighted that access to alternatives is an urgent issue. Some also underlined that credit is not an appropriate solution for all consumers, and agreed with us that access to credit needs to be part of a broader package of support made available to consumers.

6.45 Two consumer groups expressed disappointment that we are not more ambitious in this area and that our update did not include more concrete actions to develop alternatives to high-cost credit.

6.46 Some respondents shared with us their own priority activities on alternatives. These included improving credit data sharing, better distribution infrastructure, and incentives for investment in CDFIs.

6.47 Credit unions and their trade bodies highlighted credit unions' contribution to financial inclusion. They and CDFIs also emphasised how important it is to receive long-term commitments and support to enable them to scale up their services.

Our response

We are grateful for respondents' support, and for the additional information they provided about the challenges around improving access to credit. We have used this information to enhance our own understanding of the issues and potential solutions. We have reflected this in our approach to alternatives to high-cost credit, as set out in the preceding section.

We provide an update later in this chapter on the activities we have been engaged in and the further actions we will take. This includes how we are working with other stakeholders.

Summary of suggestions for FCA actions and our responses

6.48 Some respondents to CP18/12 suggested further actions we could take to help improve the availability and awareness of alternatives to high-cost credit.

Credit unions and innovation

6.49 One stakeholder said that the FCA Regulatory Sandbox is not well-known or understood among credit unions. In particular, this stakeholder argued that many credit unions do not know what the Sandbox can be used for or how they could become involved.

Our response

The Innovate Regulatory Sandbox allows eligible businesses to test innovative products and services with real consumers.[23] We welcome applications to the Regulatory Sandbox from all firms conducting or supporting regulated financial services businesses in the UK with innovative business ideas. This includes credit unions, CDFIs and similar lenders.

In response to the feedback, we will engage with credit unions and CDFIs to help them understand how the available Innovate services can assist them. We would encourage any firm or trade body to contact us if they would like to hear more about Innovate or discuss a prospective application.

Events to create solutions to alternatives issues

6.50 Another stakeholder suggested that we could hold 'tech-sprints' or other solution-oriented events focused on alternatives to high-cost credit. This stakeholder also suggested that we could dedicate a Regulatory Sandbox cohort to finding solutions to the issues around alternatives.

Our response

We agree that we have a role in bringing together relevant stakeholders to seek and implement solutions. With this in mind, we are holding an event in November 2018 which brings together housing associations and various providers of household goods to discuss how they can cooperate to improve tenants' access to goods. The aim is to showcase examples of schemes that have worked well, particularly where they

23 Further information about FCA Innovate, including the Regulatory Sandbox, can be found below at paragraphs 6.78 to 6.80 or on our website at: https://www.fca.org.uk/firms/fca-innovate.

have worked in partnership with housing associations, to encourage discussion amongst participants of how to replicate these successes more widely. We will report on the event and its outcomes shortly.

We have also recently launched the FinTech Challenge, which is an FCA Innovate pilot. This involves us taking a more active role in driving innovation in an area where we see clear benefit to UK consumers and markets. The pilot FinTech Challenge focuses on developing innovative solutions as part of the transition to a greener economy. Once the Green FinTech Challenge is completed, we will consider whether we should roll out further FinTech Challenges.

FCA-led information campaign

6.51 One consumer group suggested that we should run an information campaign to inform consumers about the alternatives to high-cost credit. This could include launching an FCA or Government webpage with information about credit options.

Our response

We agree that improving consumer awareness is a key aspect of promoting access to alternatives to high-cost credit. However, we question whether a public information campaign, which would likely be limited in time, would be an effective way of raising awareness and improving consumer understanding of the options on an enduring basis.

As our activities are funded by regulated firms, we would need to carefully consider the costs and benefits of an information campaign. We would also need to have regard to the competition implications of potentially promoting a particular type of lender over others in the market. Other stakeholders may be better placed to lead this kind of campaign.

Creating a website with consumer information could provide a longer term consumer resource. However, some consumer organisations and advice services, including the Money Advice Service, already make such information available, for example about the credit options that credit unions and CDFIs offer. In addition, online information would not reach all consumers, including some that may be particularly vulnerable.

Nevertheless, we will consider in the coming months whether there is a need to make more information about credit options available online, and where it might best be placed.

Public list of providers of lower cost credit

6.52 A research organisation proposed that we define what constitutes 'fair', 'responsible' and 'affordable' credit. We should then assess which firms meet this definition, and publish and promote the resulting list of lenders.

Our response

We do not think it would be appropriate for us as a regulator to define these terms. They can mean different things to different people. For example, we know that 'affordable credit' is regularly used to mean lower cost forms of credit that are likely to be available to consumers on low incomes. From a regulatory perspective, all credit-related regulated activity must comply with the rules in our Consumer Credit sourcebook (CONC). Consumer credit providers should only be entering into credit agreements with consumers where they have satisfied themselves that the credit is 'affordable' for the individual.

Regulatory intervention

6.53 One stakeholder suggested that we should impose a requirement on firms to signpost consumers to providers of lower cost credit as well as other sources of support, such as debt advice, when they reject loan applications. This stakeholder proposed that we could create a standardised information sheet to be given to consumers to ensure the standard of the information provided.

Our response

This kind of regulatory intervention could take a number of different forms. While the use of a standardised information sheet would ensure that all consumers receive the same information, it would be unlikely to take into account relevant local providers of credit or other services. Local information may be of particular help to consumers.

We will consider the appropriateness of a regulatory intervention and the merits of the various options, including the expected benefits and risks to consumers. We will work with industry and other relevant stakeholders as appropriate.

Regulatory environment

6.54 As noted above, we are committed to acting to improve access to credit where we are best placed to address the issues, for example where changes can be made to the regulatory environment.

Regulatory boundary for credit broking

6.55 In CP18/12 we noted that local authorities and RSLs could have an important role to play in helping tenants source essential household goods and less expensive forms of credit with which to acquire goods.

6.56 To encourage RSLs to help tenants in this way, we consulted on draft guidance. Its main aim is to provide RSLs with more certainty about the current scope of regulation when they refer tenants to lower cost credit providers like credit unions and CDFIs. In particular, it aims to clarify that referring tenants to credit providers, credit brokers and providers of goods on hire is likely to constitute the regulated activity of credit broking, and so require authorisation from us.

6.57 We also said that we believe there is a case for the Government to consider amending the regulatory boundary to remove the requirement for RSLs to be authorised by us in certain circumstances if they wish to carry on the regulated activity of credit broking.

Amending the regulatory boundary

6.58 Since the publication of CP18/12 in May 2018, we have discussed with HM Treasury the feasibility of changing the regulatory boundary for RSLs to encourage them to engage in fee-free credit broking, in particular by introducing tenants to credit unions and CDFIs, without requiring FCA authorisation.

6.59 Against this background we very much welcome the announcement in the Budget in October 2018 that '[t]he government will simplify regulation to make it easier for RSLs to direct tenants to alternatives to high-cost credit'.[24] This is part of a package of measures intended to increase access to lower cost forms of credit.

6.60 Our view is that a change to the regulatory boundary would give RSLs more certainty, and the confidence to introduce tenants to alternatives to high-cost credit without the need for FCA authorisation. This would help RSLs to build on the good practice examples that already exist by increasing referrals and encouraging the growth of existing and new local partnerships between RSLs and providers of alternatives to high-cost credit. In turn, this would improve social housing tenants' awareness of and access to alternati ves, so reducing their reliance on high-cost credit.

6.61 While we understand the current pressures on Parliamentary time, we would encourage the Government to bring forward the necessary legislation as soon as is practicable. We will continue working with HM Treasury to identify the most appropriate scope of the legislation, for example whether it should extend beyond RSLs.

Draft non-Handbook Guidance for Registered Social Landlords (RSLs)

6.62 Following the recent Budget announcement, we have considered whether the Government's intention to amend the regulatory boundary has overtaken our draft guidance for RSLs, and so would no longer need to be finalised.

6.63 We believe it remains appropriate to finalise the guidance as it still has a role to play in encouraging RSLs to help tenants access lower cost credit. More specifically:

- It is not yet known when the Government will bring forward the secondary legislation required to amend the regulatory boundary or when the change would enter into force. The guidance would serve its intended purpose in the meantime.

24 Budget 2018, paragraph 5.55, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752202/Budget_2018_red_web.pdf

- The precise scope of the amendment is not yet known. Some types of credit broking by RSLs could remain within the legislative boundary. As FCA authorisation would still be required for these activities, the guidance would continue to apply to them.

- The draft guidance goes beyond simply clarifying the existing regulatory boundary. It also explains the ways in which RSLs can help their tenants, outlines the authorisation process and fees, and encourages RSLs to contact our specialist team with any questions or requests for individual guidance.

6.64 We intend to finalise and publish the guidance shortly. We will take into account respondents' feedback and suggestions to the consultation on the draft guidance.

FCA fees for community finance organisations and credit unions

6.65 Earlier in November 2018, we proposed in CP18/34 on FCA regulated fees and levies for 2019/2020[25] to extend our existing fees concession for community finance organisations (CFOs) and credit unions by exempting them from payment of all FCA consumer credit fees.

6.66 CFOs are defined as community benefit societies[26], registered charities[27] or community interest companies limited by guarantee.[28] While the term CFO includes many CDFIs, it does not include those whose form or structure does not meet one of these three definitions.

6.67 When we took over the regulation of consumer credit in 2014, we exempted CFOs and credit unions from payment of minimum fees for the first £250,000 of credit-related income. Above that threshold, they currently pay on the same basis as all other consumer credit firms. In 2018/19, this was a minimum fee of £1,095 plus the variable rate.

6.68 We set out in CP18/34 that, having administered this concession for several years, we consider it is an inefficient use of our resources. Instead, we proposed that it would be more straightforward to treat CFOs like some not-for-profit bodies who pay no fees at all.

6.69 Any changes made would come into effect on 1 April 2019. If you have any comments on this proposal, please submit them as a response to CP18/34 by 14 January 2019.

Credit information and providers of lower cost credit

6.70 In CP18/12 we said that we could look at whether credit unions and CDFIs face potential barriers to accessing appropriate credit information from Credit Reference Agencies (CRAs). Any such barriers or other potential issues associated with the quality of credit information might impede their ability to make effective creditworthiness assessments, particularly for those consumers with a limited credit history. We have explored these issues further, particularly the aspects that may specifically affect providers of lower cost credit.

25 www.fca.org.uk/publications/consultation-papers/cp18-34-regulatory-fees-and-levies-policy-proposals-2019-20

26 A registered society under the Co-operative and Community Benefit Societies Act 2014 which fulfils the condition in section 2242(2)(a)(ii) of that Act or a registered society under the Co-operative and Community Benefit Societies Act (Northern Ireland) 1969 which fulfils the condition in section 1(2)(a)(ii) of that Act.

27 A charity: (a) registered on the Charity Commission's Register of Charities; (b) registered on the Scottish Charity Register; (c) registered on the Charity Commission of Northern Ireland's Register of Charities; or (d) that is or will be required to register on the register in (c) and which is recognised as a charity for tax purposes by Her Majesty's Revenue and Customs.

28 A community interest company limited by guarantee (within the meaning of Part 2 of the Companies (Audit, Investigations and Community Enterprise) Act 2004).

6.71 In our recent Policy Statement on Assessing Creditworthiness in Consumer Credit[29] we recognised the significant role that credit information provided by CRAs plays in lending decisions. In particular, we identified potential issues in relation to the access, coverage, timeliness and consistency of credit information and products that CRAs provide. In our 2018/19 Business Plan we announced our intention to carry out a market study in this area to gain a better understanding of the potential for harm and identify any necessary remedies. We intend to publish further details on the timescale for the market study shortly.

6.72 Our work indicates that the key relevant issues for credit unions and CDFIs are broadly similar to those identified in the wider credit market. We recognise that these lenders may often only make limited use of credit information from CRAs. They may also be more likely to assess creditworthiness by manual assessment, for example by requesting and analysing bank statements and payslips.

6.73 This may suggest that issues affecting the coverage and timeliness of credit information are particularly relevant for providers of lower cost credit to consumers who may have a more limited credit history. This can cause practical issues:

- Inconsistent coverage between CRAs. This creates difficulties in accurately establishing the extent of a consumer's indebtedness. Lenders may need to obtain information from more than one CRA to establish the fullest possible picture, which may disproportionately affect the resources of credit unions and CDFIs.
- Consumers with a limited, or no, credit history (a 'thin file'). This makes it difficult for lenders to identify or assess the creditworthiness of some consumers, other than by a manual assessment.
- Timeliness of credit information. Providers of lower cost credit may be particularly concerned about how long it takes for new credit accounts to appear on credit files, given that consumers in vulnerable circumstances may seek credit from several sources in a short period of time.

6.74 We recognise that these issues may be hindering credit unions and CDFIs in being able to make effective use of credit information provided by CRAs. They may also be commercially or technologically constrained from making better use of credit information in this sector. However, many of these issues are linked to the wider structure of the credit information market and raise broader questions around how credit information is shared, including how potential new data sources could be harnessed.

6.75 We intend to consider these broader questions as a part of our market study and will continue to monitor how the credit information market is evolving. We also recognise that new data sources could play a role in reducing the extent to which consumers are disadvantaged by having a 'thin file'. In this context, we welcome the work undertaken as part of the Government's Rent Recognition Challenge[30] to record rental repayments on credit files.

29 PS18/19, July 2018 – https://www.fca.org.uk/publication/policy/ps18-19.pdf
30 https://www.gov.uk/government/publications/rent-recognition-challenge-using-fintech-to-help-renters

Working with firms on business models and products

6.76 We work with a number of firms that want to provide products to consumers who might typically use high-cost credit, as well as firms trying to improve consumers' ability to budget and develop financial resilience. Some of these products are explicitly intended to offer consumers an alternative to high-cost credit or to meet consumer needs for which high-cost credit is often used. As we highlighted in previous publications on high-cost credit, we are keen to work with all businesses, including innovators, to explore new and innovative approaches to responsible lending.

6.77 New business models and products can benefit consumers, for example by offering more choice and improving competition, but any risks also need to be assessed and mitigated. With this in mind, we have a particular interest in understanding how new models and products are operating, whether they pose any risks to consumers or competition, and how consumers are using them.

FCA Innovate

6.78 FCA Innovate supports businesses through a range of services.

- the Regulatory Sandbox allows eligible businesses to test innovative products, services, business models and delivery mechanisms in the real market, with real consumers
- Direct Support gives innovative businesses a dedicated contact, whether they are considering applying for authorisation or a variation of permission, need support when doing so, or do not need to be authorised but could benefit from our support
- the Advice Unit gives regulatory feedback to firms developing automated models that will deliver lower cost advice and guidance to consumers

6.79 Recent examples of firms we are working with through FCA Innovate include:

- An energy supplier that is planning to offer short term loans to consumers. It intends to trial the use of energy consumption and loan repayment data with a view to being better able to assess a consumer's ability to repay and so reduce default rates among consumers who have an energy smart meter.
- A large UK retailer that intends to pilot a hire scheme for white goods with the intention of providing consumers with an alternative to RTO.

6.80 We encourage those with ideas for new business models that could help boost the supply of alternatives to high-cost credit, and who wish to benefit from Innovate services, to contact us at InnovationHub@fca.org.uk.

Authorisations

6.81 Our Authorisations teams also work with firms that want to provide products that could be alternatives to high-cost credit.

6.82 Some of these products involve new and innovative approaches to credit, for example to meet the specific needs of consumers with fluctuating incomes, many of whom work in the 'gig economy'. We have authorised firms so they can offer 'income smoothing' products that aim to flatten the peaks and troughs in consumers' income in return for a fee.

6.83 In recent months, we have granted permissions to a number of credit unions to offer an alternative means for consumers to acquire essential goods. The credit union issues a loan to a consumer by directly paying a local retailer to supply the electrical appliances the borrower needs. In this way, the consumer owns the goods while repaying the loan in weekly or monthly instalments.

6.84 We also deal with applications from firms for the permissions required to rent out white goods and other household items to consumers.

Engagement with Government and other bodies

6.85 In this section, we provide an update on how we have been engaging with Government on promoting access to alternatives to high-cost credit. We also report on our cooperation with other relevant initiatives.

Financial Inclusion Policy Forum

6.86 Following the publication of the House of Lords Select Committee Report on Financial Exclusion in March 2017, the Government set up the Financial Inclusion Policy Forum. The Forum brings together leaders from industry, the not-for-profit sector, ministers and the FCA with the aim of ensuring collaboration on financial inclusion. Its mission is to ensure that people have access to appropriate financial products and services, whatever their background or income.

6.87 We strongly support the Forum's aims and believe it is a useful platform for engaging and coordinating financial inclusion initiatives. We very much welcome the Forum's ambition to improve access to lower cost credit, and believe that it has an important role to play.

6.88 We consider that to fulfil its potential, it will be important that the Forum focuses on solutions, both short-term and longer term, and that it agrees on and implements concrete actions.

Dormant assets funds

6.89 In January 2018, the Government announced its intention to allocate around £55 million of funding from dormant bank and building society accounts to improve financial inclusion, including access to financial services for consumers on lower incomes.

6.90 We have worked closely with the Department for Digital, Culture, Media and Sport (DCMS), the Big Lottery Fund as well as HM Treasury and the Department for Work and Pensions (DWP) to develop this financial inclusion initiative with a view to maximising its impact on the availability and awareness of alternatives to high-cost credit.

6.91 In August 2018, DCMS published a Civil Society Strategy. It included an announcement that the allocated dormant assets funds will be deployed by a new, independent financial inclusion body. This was reiterated as part of the Budget in October 2018.[31]

6.92 We very much welcome that the new organisation will:

31 Budget 2018, paragraph 5.55.

- use the funds primarily to address issues of access to credit and alternatives to credit
- develop strategic partnerships with housing associations
- build relationships with other organisations working to improve access to credit, including the FCA
- aim to find sources of co-funding from a range of investors

6.93 We look forward to the new organisation becoming operational in the coming months, and will work with it as it develops and implements its strategic business plan for deploying the dormant assets funds.

No-interest loans scheme

6.94 The Budget of October 2018 included a package of measures to increase consumer access to 'fair and affordable credit'.[32] This refers to credit products that consumers on low incomes can access, which are also cheaper than high-cost credit products.

6.95 We very much welcome the Government's announcement in the Budget that it will launch a feasibility study early next year with a view to designing a pilot for a no-interest loans scheme. The current demand for credit by consumers on low or irregular incomes suggests that there is a need for a scheme that gives access to small loans to consumers who cannot afford interest-bearing loans.

6.96 The feasibility study will need to consider a number of complex issues. These include the eligibility criteria for a no-interest loan, the purposes for which the consumer may use the loan, and how the scheme would be financed in both the short and longer term. We look forward to working with the Government and other stakeholders on these issues.

Affordable Credit Challenge Fund

6.97 We also welcome the Budget announcement that an Affordable Credit Challenge Fund will be created.[33] This will consist of £2 million to promote innovative fintech solutions to the challenges that lenders such as credit unions and CDFIs face.

6.98 We would encourage the use of this fund to implement solutions that contribute to improving the sustainability of these lenders, so enabling them to serve consumers on low incomes in the longer term.

Green Paper on Social Housing

6.99 In August 2018, the Ministry of Housing, Communities & Local Government (MHCLG) published a Green Paper 'A new deal for social housing'.[34] The paper notes that many social landlords play an important role beyond their key responsibilities as housing providers.

6.100 We welcome that MHCLG explicitly recognises the important role that housing associations play in the financial inclusion of their tenants, including through financial guidance, signposting to lower cost credit providers, and offering furniture rental.

32 Budget 2018, paragraph 5.55.
33 Budget 2018, paragraph 5.55.
34 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/733635/A_new_deal_for_social_housing_print_ready_version.pdf

6.101 We agree that these services can help to increase the financial resilience of tenants. They can also contribute to increasing tenants' awareness of alternative options, and so reduce reliance on high-cost credit.

6.102 We will continue to engage with MHCLG as its work on the future of social housing progresses.

Scottish Government

6.103 In its Programme for Government published in September 2018,[35] the Scottish Government explained how it intends to improve access to lower cost credit.

6.104 It is investing £1 million in the Affordable Credit Fund launched by the Carnegie UK Trust earlier this year. The fund aims to provide new financial support to not-for-profit credit providers with a view to helping them extend their services to more people.

6.105 The Scottish Government is also developing options to improve access to lower cost credit and other financial services for young people leaving care.

6.106 We welcome these developments and will continue to work with the Scottish Government as it takes them forward.

Money Advice Service and Single Financial Guidance Body

6.107 In June 2018, the Money Advice Service (MAS) published its Working-Age Money-Management Commissioning Plan: Call for Evidence.[36] The Commissioning Plan, on which MAS intends to consult, will set out a programme of work which enables more working-age adults to manage their money better through budgeting, saving and credit use.

6.108 We welcome the inclusion of credit use in the Commissioning Plan, and agree there are important links between credit, savings and budgeting as tools of money management that can contribute to financial resilience.

6.109 We will continue to engage with MAS as its work progresses and it transitions into the Single Financial Guidance Body (SFGB).

6.110 We believe the formation of the SFGB will provide consumers with a simpler route to obtain help and guidance. We look forward to working closely with the SFGB to achieve good outcomes for consumers.

End High Cost Credit Alliance

6.111 The End High Cost Credit Alliance was launched in March 2018. It aims to bring about the change considered necessary 'to deliver healthy credit for all and an effective safety net for those individuals who need it'.[37] The members of the Alliance work together to present the case for change, giving support to providers of alternatives to high-cost credit and organisations delivering debt advice. They agree and collaborate on actions to further these aims.

6.112 We are Observers to the Alliance and contribute to its discussions on alternatives to high-cost credit. Our participation provides us with a further channel of

35 https://www.gov.scot/publications/delivering-today-investing-tomorrow-governments-programme-scotland-2018-19/
36 https://www.moneyadviceservice.org.uk/en/corporate/working-age-money-management-commissioning-plan-call-for-evidence
37 https://the-alliance.org.uk/

communication with providers of lower cost alternatives. This contributes to our understanding of the challenges they face, and what potential solutions might look like.

6.113 We welcome the additional public debate about alternatives to high-cost credit that has been generated by the launch of the Alliance. We hope this will contribute to increasing overall public awareness of alternatives.

Next steps

6.114 We intend to finalise our guidance to RSLs shortly. We will also provide any further updates on our work to promote alternatives to high-cost credit, including a report on our event for housing associations and providers of household goods.

Annex 1
Questions in this paper

Q1: **Do you agree with our assessment of harm to consumers from high prices?**

Q2: **Do you agree with our assessment that other measures will not be fully effective in reducing harm from high prices?**

Q3: **Do you agree with our approach to benchmarking base price?**

Q4: **Do you agree with proposals for a total credit cap?**

Q5: **Do you agree with our proposals on controlling the price of TAD cover?**

Q6: **Do you agree with our approach to controlling the price of arrears charges?**

Q7: **Do you have any views on the implementation timetable?**

Q8: **Do you agree with our assessment of the costs and benefits of these proposals?**

Q9: **Do you agree with our initial assessments of the impacts of our proposals on the protected groups? Are there any others we should consider?**

Annex 2
Cost benefit analysis

Introduction

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 other impacts, we provide an analysis of outcomes in the relevant dimensions. Our proposals are based on carefully weighing up these multiple dimensions and reaching a judgement.

3. This Annex first describes the RTO sector, explains the problem and our rationale for intervening, describes the intervention, and then provides our estimates of the costs and benefits of the intervention.

The RTO sector

4. We estimate the RTO sector consists of around 20 firms.[38]

5. There are two large firms in the RTO sector (these are Brighthouse and Perfect Home). These two firms together account for over 90% of the outstanding balances on RTO agreements. The largest three firms account for over 95% of outstanding balances.

6. The market has declined in size in the last few years, falling from £700m of outstanding balances in 2015.[39] The total size of the RTO sector as measured by outstanding balances is less than £400m, according to regulatory reporting data. We note that the level of outstanding balances will continue to fall as the lower level of sales feeds through into the stock of outstanding balances.

7. Again, using regulatory reporting data, other firms have relatively low levels of outstanding balances and new lending. Each of these smaller firms have outstanding balances below £3m and made less than £2m of advances in the last year for which they reported data.

38 Firms are not required to tell us that they are undertaking RTO activity. We have identified these firms using our knowledge of the consumer credit markets, regulatory reporting data and through desk research.

39 FCA, High-cost Credit Review Technical Annex 1: Credit reference agency (CRA) data analysis of UK personal debt July, page 87

Problem and rationale for intervention

8. In this section, we describe the drivers of harm and the nature of harm. We are concerned that vulnerable consumers who have, or believe themselves to have, very limited options, are purchasing household and other goods at very high prices, without using the information they have on the total costs, purchase appropriately within their decision-making. These consumers' vulnerability means that any financial harm they suffer will have a disproportionate impact on their well-being.

Drivers of harm

9. The drivers of harm fall into three categories: consumer focus on weekly payments, the perception of lack of options and the financial literacy of RTO consumers. These three drivers are set out in the next three sections. The focus on weekly payments is a behavioural bias. The perception of lack of options is a competition problem as consumers do not properly assess alternatives and switch to better-value choices. Finally, there is an informational asymmetry as RTO consumers lack the financial literacy to understand the features of RTO products.

Focus on weekly payments

10. RTO customers focus on the weekly cost of their agreements, and total cost is not an important consideration. They therefore suffer from myopia in their decision making,[40] a type of behavioural bias. RTO customers are also more focused on being accepted for an agreement, and obtaining the good they are shopping for, than on the total cost of the agreement. This means they are less likely to find cheaper alternatives and reduces the competitive pressure that greater shopping would impose on the pricing of RTO firms. In addition, RTO customers are among the least creditworthy, even compared with other high cost borrowers, which can limit their alternative sources of credit. We also see evidence of lack of understanding of financial products that may contribute to consumers taking out expensive agreements and suffering harm. We note that for some consumers taking out an expensive RTO will be the best, and sometimes only option, available.

11. Anecdotal information from firms, qualitative research, and survey evidence all show that when choosing RTO agreements consumers focus most on weekly payments and give much less consideration to the total cost. Consequently, consumers tend to ensure that their repayments are affordable. We see this focus on weekly payment, to the exclusion of consideration of total cost, however, as a driver of harm in how consumers assess whether they should buy an RTO product.

12. In our survey of RTO customers, we asked what the most important aspect of the transaction to their decision to use RTO. 49% said it was keeping the weekly payments low. Only 15% said it was the overall cost. Similarly, when we asked which factors were important to their decision to use RTO, 63% said weekly payment was "extremely important," compared with only 34% for product price.

Perception of lack of options

13. Survey evidence shows that most RTO customers believe that they have very limited alternative options for obtaining the items they seek to purchase through RTO. Our analysis of credit reference agency data shows that while some would likely be able to find credit elsewhere, the majority of consumers would find it difficult or impossible to

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

obtain credit from other commercial sources. However, we expect a small proportion of consumers could access products using other forms of credit elsewhere.

14. When asked about other options they believed they had for purchasing the item they obtained through RTO, roughly half believed they had no other options; only 15% listed another credit product as an option.

15. This belief that they do not have options appears to lead many RTO customers to not shop or compare prices outside of RTO, which means that they are less likely to recognise RTO's high cost. In our survey, only 28% of RTO customers considered buying elsewhere. Similarly, 46% percent of customers either did not look at the price of the product from the RTO retailer or did not compare that price with other retailers' prices.

16. Consumers are generally aware that purchasing a product from an RTO retailer is more expensive than buying the product outright. Our survey found that 61% of RTO customers were aware that buying a product using an RTO agreement would be more expensive than buying from another retailer. However, a significant minority – more than one third – thought that using RTO was no more expensive than buying elsewhere. We note that our analysis of pricing found that customers using an RTO agreement paid in total, on average, 2.7 times[41] more to purchase the product than they would paying cash at another retailer (for agreements with insurance and extended warranties the average is nearly 3).

17. Consumers' lack of options, both actual and perceived, means they are less likely to find cheaper alternatives and reduces the competitive pressure that greater shopping would impose on the pricing of RTO firms.

Financial Literacy

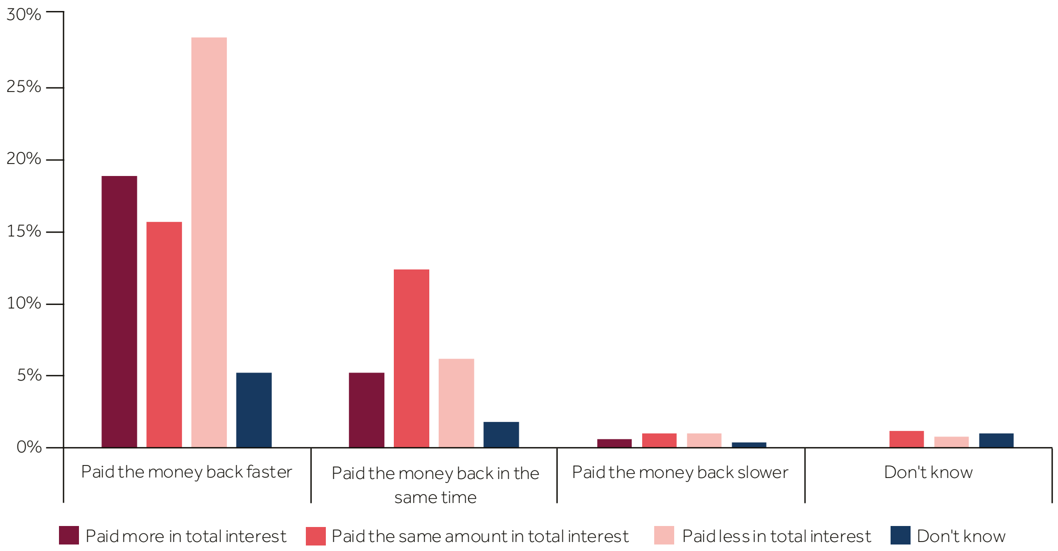
18. There is also evidence that RTO customers do not understand important features of their agreements. In particular, many consumers do not understand the relationship between weekly payments and total cost. In our survey, we asked consumers two questions about the implications of paying more back per week.

- If you had been able to pay back more per week, do you think you would have paid the money back faster, slower, or in the same time?
- If you had been able to pay back more per week, do you think you would have paid more, less or the same in total interest, compared to what you actually paid?

19. Survey responses to these questions are presented in Figure 1. The x-axis groups survey respondents together by their answer to the first question. In total, 68% of respondents correctly answered this question (the leftmost group on the x-axis), while the remaining 32% answered this question incorrectly. The bar chart shows that, of the 68%, most do not realise that if they pay back the lending faster they would pay less in interest. Overall, only 29% of RTO customers correctly answered these two questions. Hence most customers appear not to understand the basic relationship between weekly payments, term length and interest costs.

41 At the two largest RTO firms.

Figure 1: Consumer understanding of interest rates



Source: FCA analysis of consumer survey undertaken by PwC Research (based on 498 respondents)

20. These findings suggest that consumers do not understand basic features of how agreements function and how the low weekly payments of RTO agreements, especially for longer-term agreements, lead to very high total costs of borrowing.

Description of harms

21. Harms to consumer arise in three key ways:

- Vulnerable consumers are paying significantly above mainstream retail prices.
- Many consumers buy RTO products without using the information provided to them on total cost in their decision-making and therefore they do not make an appropriate judgement about whether the price is worth paying.
- Some consumers buy RTO products despite there being an alternative way for them to acquire a similar product at lower cost.

22. The cost to consumers of using RTO is considerably above that of alternative ways of purchasing the same good. We note that the average cost of acquiring a product through an RTO agreement is roughly 2.7 times higher than purchasing it from other retailers. This can be significantly higher for 3 year agreements and when add-ons are purchased. Consumers that enter into three-year agreements, on average pay almost 3 times more than they would if they purchased from a mainstream retailer.

23. Given the high price of RTO products and the fact the consumers focus on other aspects of the agreement at the time of the transaction, we might expect there to be significant regret by consumers over time if they come to appreciate the total cost. On the other hand, if consumers are happy with the underlying products and do not focus on the overall cost, we would not expect to see high levels of regret.

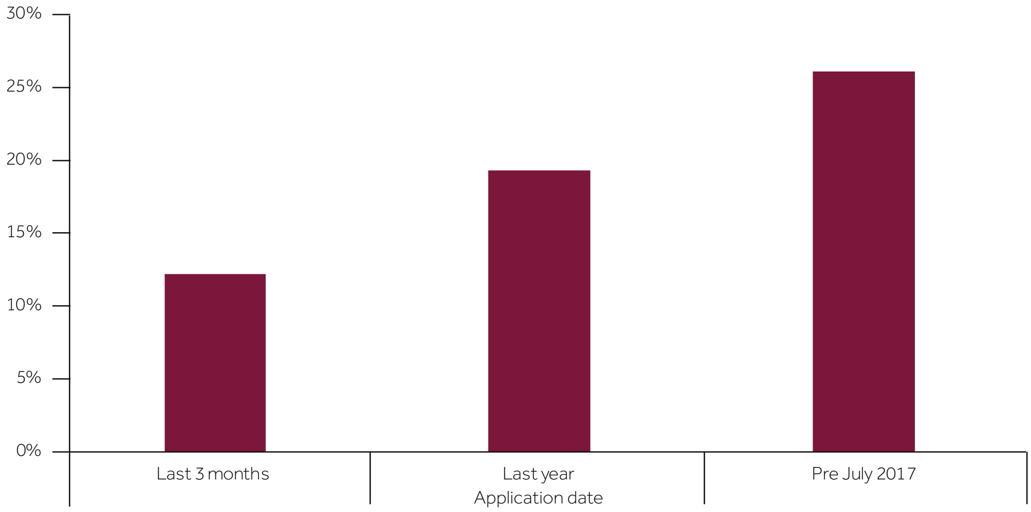
24. Over 72% of respondents to our survey did not consider buying their product from an alternative source. This contrasts with those consumers who were declined for an RTO agreement who subsequently sourced the product in an alternative way. Over 50% of consumers declined for an RTO agreement managed to get a product from somewhere else. Only a minority of these consumers used credit to obtain the product.

25. Responses to our survey suggest that many consumers underestimate the total cost of their agreements. We asked consumers to state the weekly payment on their RTO agreement and to state the contract length in weeks. Multiplying these together should give the total cost of the agreement. We also asked consumers about the total cost of the agreement. When we compared these figures, we found that most consumers gave a total cost figure below that implied by their responses to the weekly payment and total number of weeks questions. We would expect consumers to make mistakes in these estimates but we expect that, on average, these mistakes would not be systematically above or below the implied total. However, we find that on average, their response to the total cost question were 15% below the implied total cost. This suggests that, for a given cost and term length, consumers systematically underestimate the total cost of the product at the point we undertook the survey. It is possible that this is an artefact of the delay between consumers taking out the RTO agreement and being surveyed. However, we view the most plausible reason to be that consumers do not take into account the total costs of RTO purchases when making an RTO purchase. While not a key harm we are trying to address, these findings are used in our estimation of the impact on consumers who are no longer served as a result of our proposed cap.

26. We find some regret in the use of RTO. Around 20% of consumers regret buying their RTO product. As shown in Figure 2, this regret increases with the length of time since product purchase. For consumers that bought their product over a year ago, 26% regret buying the product. In our survey, we also asked consumers who no longer use RTO the same question; nearly a third of these consumers regretted using RTO.

27. Of those consumers who stated they did regret buying their product from an RTO retailer, 84% said that is was due to the total cost being expensive.

Figure 2: Regret in the use of RTO



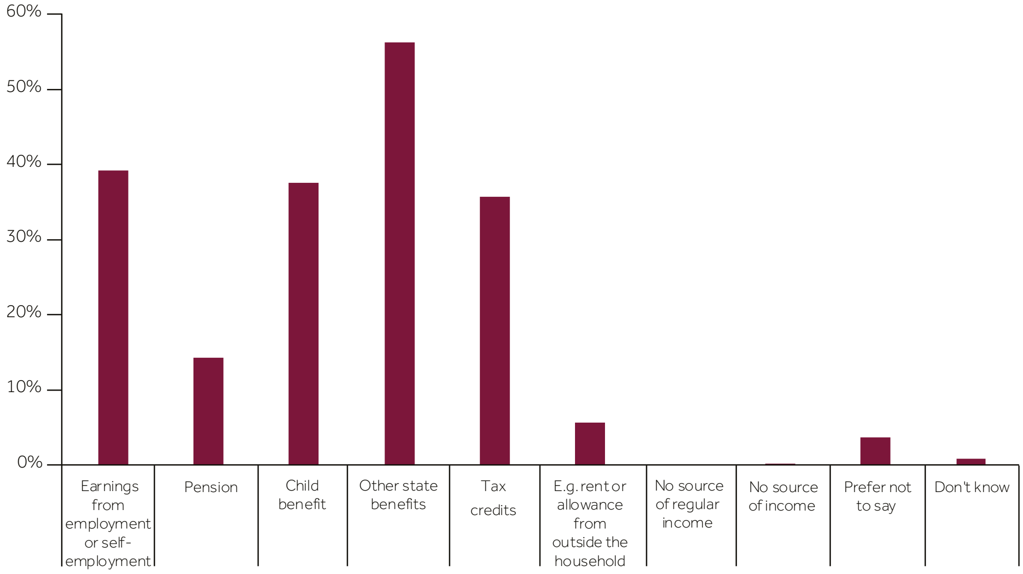
Source: FCA analysis of consumer survey undertaken by PwC Research (based on 498 respondents)

Vulnerability of consumers affected

28. RTO customers typically have very low levels of income and are in precarious financial situations. For these consumers, any financial harm is likely to have a greater impact on their well-being compared with the population as a whole. We consider a number of ways in which consumers could be considered vulnerable.

29. Figure 3 shows the sources of income for RTO customers. The most common source of income is state benefits; fewer than 40% of RTO customers have income from employment, with more than half of consumers receiving some form of state benefits.

Figure 3: Income sources for RTO customers' households

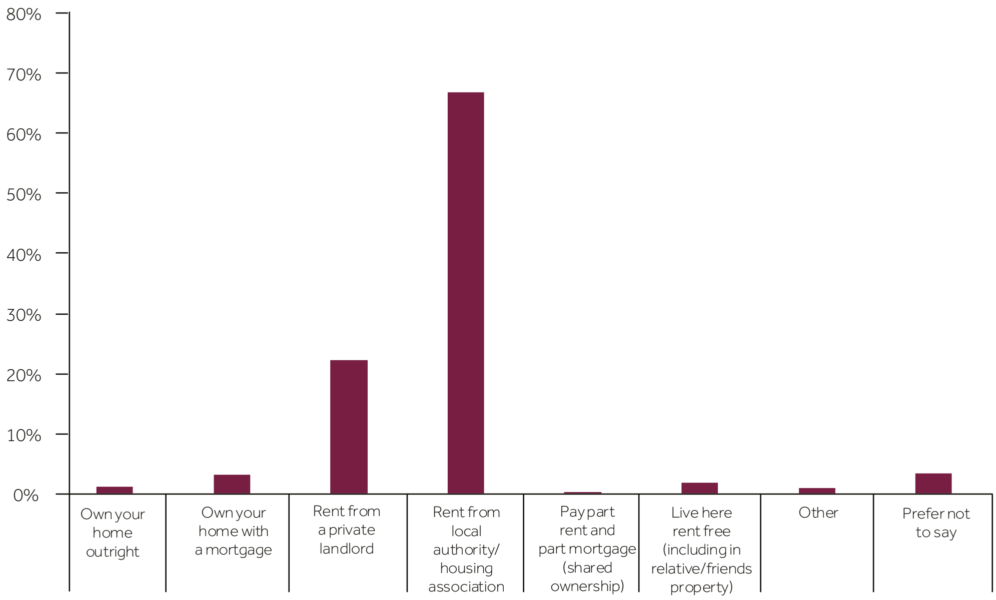


Source: FCA analysis of consumer survey undertaken by PwC Research (based on 498 respondents)

30. In addition to having low income, RTO customers' wider financial situation is also challenging. Nearly 60% of RTO consumers reported that they had no savings.

31. We also found that more than two-thirds of RTO customers live in local authority or housing association accommodation (see Figure 4). Hardly any RTO consumers own their own home. This contrasts with the general population, in which 63% own their own home and 17%% live in local authority or housing association accommodation.[42]

Figure 4: The housing type of RTO customers

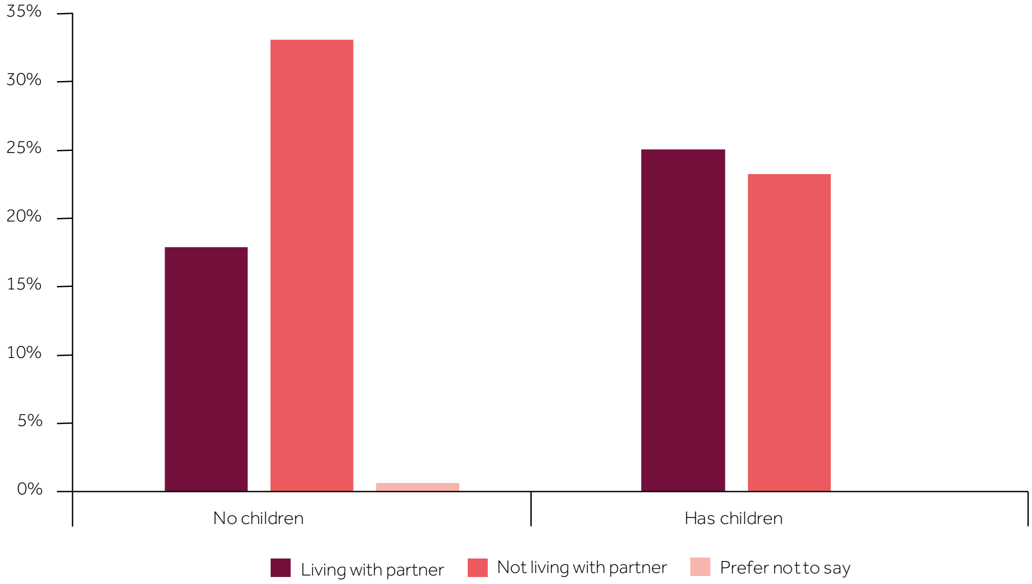


Source: FCA analysis of consumer survey undertaken by PwC Research (based on 498 respondents)

42 See https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/632464/Social_rented_sector_report_2015-16.pdf

32. We find that users of RTO are much more likely to be part of a single parent household. Twenty-three percent of RTO customers are single parents of children under 16. This compares to around 9% of all household in the general population.[43]

Figure 5:The households of RTO consumers



Source: FCA analysis of consumer survey undertaken by PwC Research (based on 498 respondents)

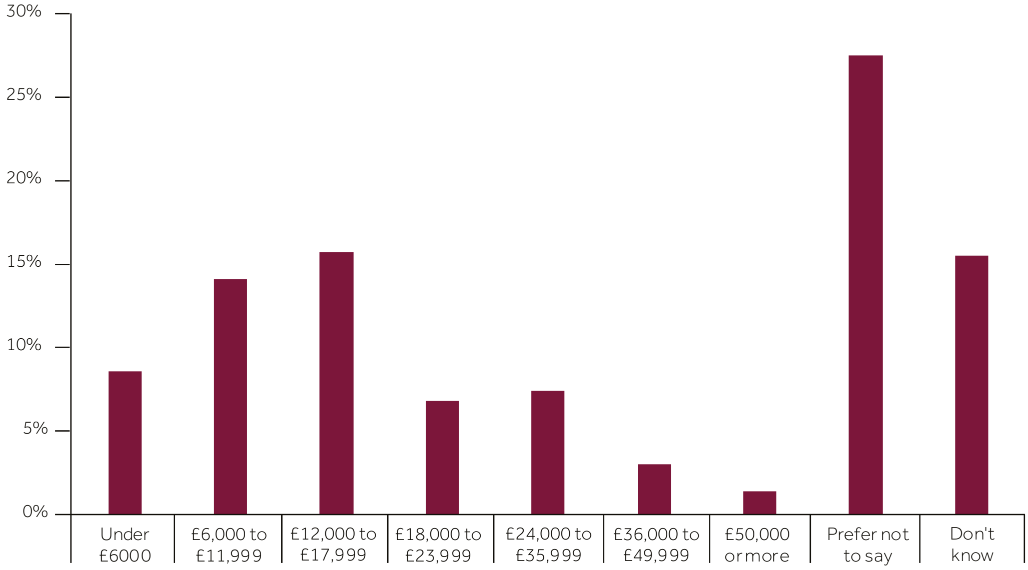
33. Figure 6 shows the distribution of RTO customers' household income, based on our survey. The median household income among RTO users was between £12,000 and to £18,000 per year. If incomes were uniformly spread in this band of income, then the median household income would be below £15,000 per year. In contrast, the UK median disposable household income was £28,430 in the financial year ending 2018.[44 45]

43 FCA analysis of data from the ONS, Families and Households: 2017, https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/families/bulletins/familiesandhouseholds/2017

44 ONS, Household disposable income and inequality in the UK: financial year ending 2017, based on the Office for National Statistics's (ONS's) Living Costs and Food Survey, https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/householddisposableincomeandinequality/financialyearending2017

45 We note that there are a significant number of non-responses to this question. We might expect that this could bias our estimate of income downwards but we would still expect that the typical RTO users has household income significantly below the UK median. The UK median disposable household income is 'equivalised' which means it takes into account the composition of the household. For example, household income is adjusted downwards if there are children within the household. We have not equivalised the income estimates here given the responses are banded but we would not expect any equivalisation to make a material difference.

Figure 6: RTO customers' annual household income



Source: FCA analysis of consumer survey undertaken by PwC Research (based on 498 respondents)

34. The Department for Communities and Local Government produces an index of multiple deprivation for local geographic areas, and we can match consumers in credit reference agency files to ONS geographic areas using postcodes.[46] Figure 7 shows the distribution of the index of multiple deprivation in the areas where four groups of consumers live: all consumers in our random sample of UK credit reference agency records, those using high-cost short-term credit (payday loans), those using home collected credit, and those using Rent-to-own products.[47] A high index value implies a greater degree of deprivation within the local area (1 is the 10% of least deprived area and 10 the most deprived).

35. In Figure 7 we observe that users of RTO typically live in more deprived areas than other consumers and high cost credit customers, and in areas with similar levels of deprivation to those where home collected credit customers live. This analysis does not show whether individual RTO customers are deprived, but it provides additional evidence of their relative financial position.

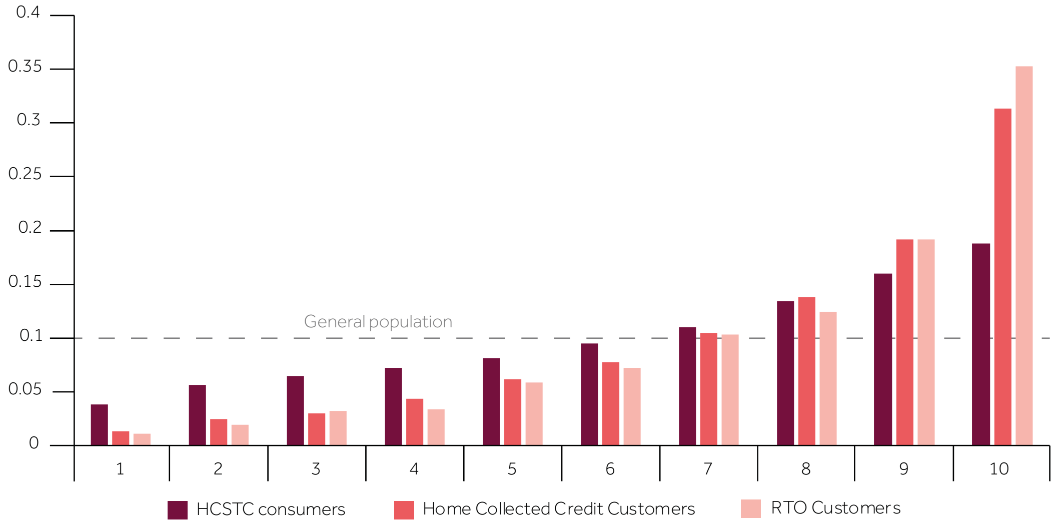
36. Our analysis also showed that RTO customers are among the least credit-worthy consumers, even among high-cost credit customers (see our High-cost Credit Review Technical Annex 1 for more details).[48]

46 See https://www.gov.uk/government/statistics/english-indices-of-deprivation-2015

47 The index of multiple deprivation is produced for England only. Hence this analysis focusses on RTO customers in England. We have no reason to believe that looking across the UK the results would be materially different.

48 https://www.fca.org.uk/publication/feedback/fs17-02-technical-annex.pdf

Figure 7:[49] The level of deprivation in the areas where RTO customers live



Source: FCA Analysis of data from the ONS and a credit reference agency

Our intervention

37. Our proposed price cap in the RTO market is designed to control prices by:

- Requiring firms to ensure that they set their base prices, including delivery and installation, at or below a level calculated by reference to other retailers' prices.
- Requiring firms to keep to a total credit cap of 100%. This will ensure that consumers do not pay credit costs higher than the price of the product, including delivery and installation.
- Preventing firms from charging RTO consumers higher prices for insurance premiums, eg theft and accidental damage cover, purely to recoup lost revenue once the price cap comes into effect.
- In the same way, preventing firms from changing their arrears charging structure to recoup lost revenue.

Controlling base price

38. We propose rules that would require a firm to benchmark the retail price of any product it intends to sell through RTO against the prices of other retailers. Firms would need to have their own policies and procedures explaining how they do this.

39. We are proposing that a firm benchmarks its base price by setting it:

- no higher than the median of 3 mainstream retailers' prices (which can include no more than 1 catalogue credit retailer); and
- where a catalogue credit retailer does not sell the product, no higher than the highest mainstream retail price of the other 3 retailers.

49 It should be noted that not every person in a highly deprived area will themselves be deprived.

40. Here, 'mainstream retailers' prices exclude other RTO firms and prices that are so far outside the range of other prices they have found that no reasonably informed consumer would be likely to pay them. But it could include small, independent retailers.

41. We propose that firms can only include 1 catalogue credit price in their calculations. This will ensure they have to use a range of prices that must include retailers who do not mainly sell through combining products with credit.

42. Where the same product is not sold by other mainstream retailers, the firm would need to benchmark by finding a 'comparable product', based on quality, size, performance and functions, and follow the approach outlined above. If the RTO firm can't find three other retailers who are selling the same product, then any shortfall would need to be made-up by finding the relevant number of prices for comparable products.

43. We do not propose applying benchmarking rules to second hand or refurbished goods.

44. Our proposed rules require firms to benchmark against what other retailers charge for similar services by product type, eg washing machines or fridges, rather than individual products, eg model number.

45. It is important that firms keep their benchmarking up-to-date. So, in addition to requiring firms to benchmark base prices when they first start selling a product, our rules would also require this if they change a product's base price, and within 12 months of the last time the benchmarking was carried out.

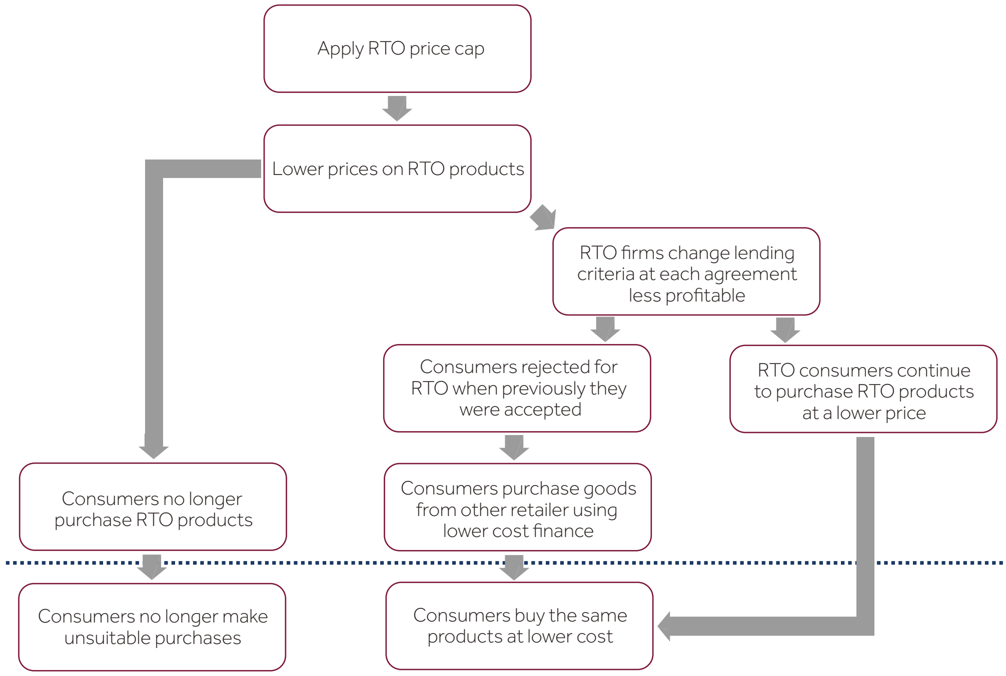
46. We propose requiring firms to keep records that demonstrate, in each instance, how they have set base prices for each of their products. This would include 'point-in-time' evidence of the other retail prices they benchmarked against, e.g. screengrabs of online comparisons or the results of third party benchmarking data. When an identical product is not available, firms would be required to demonstrate that they took reasonable steps to identify that the exact same product wasn't available on the market. For example, documentation of the firm's online searches, or confirmation from a manufacturer/distributor that they supplied a product exclusively to the RTO firm. Firms will need to provide this information on request to our supervisors.

How our intervention delivers benefits to consumers

47. The main benefit to consumers from reduced harm comes from consumers buying the same products using RTO but at lower prices as a result of the cap. Some consumers may benefit if they lose access to RTO but acquire the good more cheaply as a result (as indicated by our survey results). We also think there will be benefits to some consumers that no longer buy, or acquire, any product as a result of the cap. This is because for some consumers buying RTO products may make them worse off than they would be if they did not acquire the good at all.

48. The causal chain does not include all the impacts we expect from the cap. Rather, it sets out the mechanism by which we expect harm to be reduced. For example, some consumers who are no longer able to buy or acquire a product as a result of our cap will be worse off. The causal chain does not include these costs.

Figure 8: Causal chain



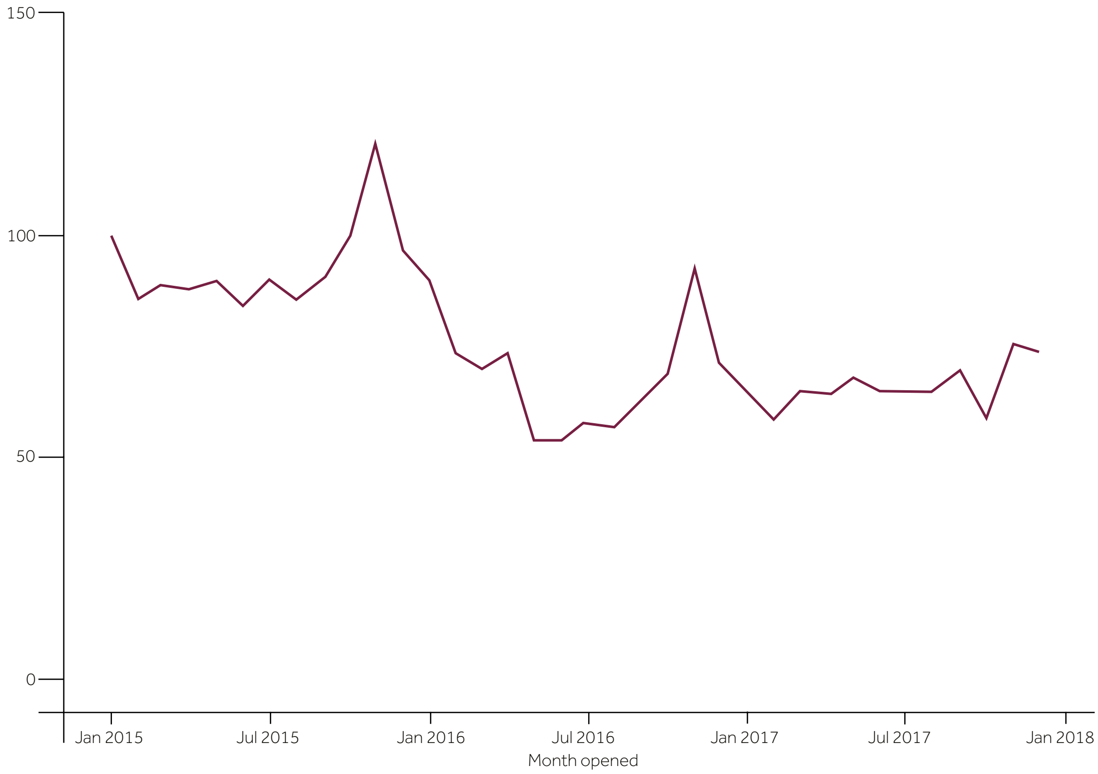
Baseline and key assumptions

The baseline

49. The RTO market has declined in the recent past (see Figure 9). This is primarily the effect of falling sales due to regulatory activity undertaken by the FCA, to ensure that the two largest firms in the market became compliant with affordability requirements. These changes also led to the two largest firms reducing the number of stores they operate.

50. Predicting how the market will evolve in the face of this significantly lower sales volume is not reasonably practicable. Firms are still adjusting their business model to account for the lower stock of agreements they hold from before the FCA action. It is difficult to predict how profitable firms will be once in steady state. However, we expect that the level of sales at the two largest firms to have stabilised and we think it reasonable to assume that this level of sales would continue into the future. We therefore think it is reasonable to assume for our baseline that firms continue operating at their current sales levels.

Figure 9: Declining sales volumes in RTO
Monthly RTO originations (relative to January 2015)



Source: FCA analysis of credit reference agency data

51. We are introducing rules to ban the sales of extended warranties at the point of sale. These changes will reduce the revenue and profits that firms make from extended warranties. We consider the ban as part of our baseline and therefore, when measuring the impacts on RTO firms, we have assessed the impacts of the cap on top of the effects of the ban on the sale of extended warranties at the point of sale.

52. We note that including the POS ban on extended warranties in our baseline has little impact on our overall assessment of the impact of the cap. This is because changes in the expected revenue from extended warranties will not greatly affect the decision to lend to an individual consumer by an RTO firm. Further, the contribution of extended warranties to the overall revenue and profitability of the firm is relatively small, compared to other revenue streams.

Key assumptions in our analysis

53. There are a number of assumptions that we have had to make to develop this cost benefit analysis. The main assumptions we have made are:

- Our estimates of the proportion of consumers that will not be served under the proposed cap
- The impacts on consumers that are not served by RTO firms under the cap
- The impact of the cap on smaller RTO firms, where we have less information than for the largest two firms.

54. Each of these assumptions is described in the analysis where we discuss this impact of these assumptions.

Summary of costs and benefits

55. The following table sets out the costs and benefits of the proposed price cap. We note that comparing the total costs and benefits of the proposed cap, the costs outweigh the benefits. However, given the low incomes of the consumers that use RTO we provide an alternative (weighted) comparison of total costs and benefits. We do this by increasing the weight we attach to consumer benefits relative to the costs to firms (see the section on distributional considerations for further discussion).

Figure 10: Summary of costs and benefits

	One-off/ Ongoing	Costs	Benefits
RTO firms	One-off	Benchmarking costs – £160k	
		Familiarisation and legal costs – £10k	
		IT costs – £260k	
		Change and governance – £340k	
	Ongoing	Revenue costs – £29.2m per year	
		Benchmarking costs –£310k per year	
Consumers	Ongoing	Additional search costs- £120k per year	Lower prices for RTO products – £17.9m ongoing
		Costs arising from lack of access to product – £0.2-2.8m per year	Buying products from lower cost retailers – £4.6m ongoing
			Consumers avoid buying products they value below price – £0-510k
Other retailers	Ongoing		Additional revenue from sales diverted from RTO – £1.0m
FCA	Ongoing	Supervision costs – less than £50k per year	
Total (unweighted)	One-off	£770k	
	Ongoing	£29.9-32.4m per year	£23.5-24.1m
Total (weighted for low consumer incomes)	One-off	£770k	
	Ongoing	£30.1-34.2 per year	£37.0-37.8m

56. We use the weighted totals to inform our view of the proportionality of the proposed prices cap. The weighted results show that the proposed cap leads to an increase in welfare and hence is net-beneficial.

Costs

Firm costs

Loss of revenue and profits

57. We estimate that gross revenue for the RTO sector falls by around £32.9m per year. There is a smaller impact on the net revenue of RTO firms (as measured by the difference in revenue and the costs of the good). We estimate this reduction at £29.2m per year. The following paragraphs describe our analysis and estimation of these costs to RTO firms.

58. We first consider the impact of the price cap on the two largest RTO firms. Later in the section, we describe how we estimated the impact on the other smaller firms in the sector.

59. The direct effect of a price cap on firms is a reduction in total revenue that firms can earn from the sale of products. If a price cap is set above the current of RTO firms, the cap will likely have no effect. If the price cap is set below the current market price, firms will be forced to lower their prices and hence earn less revenue on products. In addition, some agreements which were previously profitable could become unprofitable with the price cap. If a price cap is set above the current prices of RTO firms, the cap will likely have no effect. If this occurred, we would expect firms to adjust their lending criteria and possibly not approve some agreements that would have been approved without the cap. In the medium term, a price cap may also cause firms to adjust product mixes and/or product terms; it is not reasonably practicable to predict effects on product mixes and product terms.

60. We simulated the effects of benchmarking of base prices and the total cost of credit cap on firms' gross and net revenues using agreement-level data from the two largest firms in the market. Because RTO firms sell the products as well as providing the financing, "gross revenue" includes all payments made on the agreements.[50] Net revenue was calculated as gross revenue minus the cost of goods sold. The value of returned items was accounted for using straight-line amortization over the term of the agreement.[51]

61. The simulations were done by first imposing the estimated impact of benchmarking on product prices and then capping the interest that could be charged as no more than the price of the product.

62. Firms may attempt to recover lost revenue by raising interest rates to the level of the cap. We therefore estimated versions of the simulations where firms do not react in any way to the cap, and versions where firms react to the reduction in the base price by increasing interest costs, but no higher than that allowed under the cap. The latter estimates, which we consider to be more realistic, are used in our overall assessment of impacts, as shown below. This is because we would expect these latter estimates to be more realistic as we would expect firms to adjust interest rates or base prices to set weekly prices as close as possible to the price before the cap while complying with the cap.

50 We also included payment for other related services, such as for insurance in calculations of revenue, but did not adjust revenue from those services, as they are not covered by the cap.

51 Straight-line amortization likely overstates the value of items returned early in an agreement and understates the value of items returned later in an agreement. Any inaccuracy this introduces will only affect estimates where the number of agreements made are changing.

63. We also attempted to estimate the effects of benchmarking and a cap on firms' willingness to offer agreements by assuming that firms will not offer agreements with expected net revenue below that of their least-profitable current agreements. We determined this by measuring the expected net revenue of customers based on the firms' internal credit scores.

64. We then simulated the effects of a cap on the expected net revenue of twenty groups defined by credit score. Any group for which the cap pushed average revenue below the current expected revenue of the lowest score group was assumed to no longer receive agreements.

65. This exercise showed that the cap could be expected to have little effect on firms' willingness to offer agreements. We estimated that less than 5% of agreements would no longer be offered as a result of the cap. This may appear surprising given that the price reductions on some products will be substantial. However, we expect nearly all agreements to remain profitable even in the fact of substantial reductions in the prices of some agreements.

66. In addition to this simulation, a reason to expect a very limited impact on firms' willingness to offer agreements is that they are likely not currently offering agreements to marginally profitable customers. During the Authorisation process the firms raised their underwriting standards, causing them to reject a large number of applicants who they previously would have accepted. This suggests that their least profitable current customers provide more than the minimum expected profit that the firms would accept and be willing to offer agreements.

67. To take a conservative approach, however, we assume that firms stop offering 5% of the agreements they currently offer.

68. Using this approach, we estimated the impact of the cap:

- Based on the simulations of revenue impacts, we expect revenues on sales to fall by 5% as a result of sales that are no longer made because of the cap.
- In total, including reduced revenue on sales made and lost revenue from sales not made, we estimate that gross revenue for the RTO sector falls by around £32.9m per year.
- These changes also lower RTO firms' cost of goods sold through the effect on the number of sales made. Therefore, there is a smaller impact on the net revenue of RTO firms (as measured by the difference in revenue and the costs of the good).[52] We estimate this reduction at £29.2m per year. This is our estimate of the costs to firms from lower revenue resulting from the cap.

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

70. Firstly, firms are required to apply affordability assessments which prevent some consumers who could profitably be lent to from accessing an RTO agreement. The lower prices (and weekly repayments) will mean that some of these agreements

52 This analysis does not take into account the additional variable costs of entering into a RTO agreement. The analysis therefore overestimates the effect on net revenue.

become affordable where previously they were not, thereby expanding the pool of potential customers. These consumers would be accepted for RTO agreements where previously they would not have been.

71. Secondly, on the demand side, we would expect lower prices to attract more consumers to apply for RTO agreements, leading to additional sales. We do not think it is reasonably practicable to estimate these effects as we would have to estimate the price elasticity of individual products. This is because firms sell several thousand products per year. Further, we may not see enough price variation in products to enable such analysis to be robustly undertaken. We have not quantified these additional sales and the associated revenue that firms would earn under the cap.

72. We also note that our analysis will slightly overstate the loss in net revenue. This is because we have not accounted for all the other costs associated with particular sales, apart from the costs of goods sold. For example, there will be some additional costs to setting up and managing agreements that we have not accounted for in the analysis. Further, neither have we accounted for funding costs for individual agreements.

73. Our analysis of the prices at the third largest RTO provider suggests that our cap will also impact their revenue. However, using analysis of this firm's prices, we would expect only a narrow range of products to be affected. By identifying the proportion of products affected by the cap and the average amount the prices of these products would need to fall under the cap to be compliant, we calculate the revenue impact for this firm from reducing prices to comply with the cap. Given the impact on prices for this firm is relatively modest we do not expect consumers to lose access to RTO as a result. While we might expect on the margin that some will lose access, we expect the number of consumers to be minimal.

74. For the remaining small firms in the market, we expect around half the firms to be affected by the cap and therefore lose revenue as a consequence of the proposed cap. Based on desk research, we identified firms whose current pricing is likely to be impacted by the requirement to benchmark product prices or by the total cost cap. We therefore apply similar revenue reduction of the two largest firms to the small RTO firms. These estimates are included in our estimate presented above.

75. We note that consumers who have already purchased a product before the cap may have an incentive to return the product and buy another once the cap is implemented and prices fall. We do not think this effect will be particularly large. Returns are common at one retailer but not so at other retailers, as one retailer markets the ability to return as a key benefit of their RTO agreements. In addition, consumers will already have paid off some of their agreement and therefore it may not be cheaper to return and buy another product after the cap is introduced. This is because the reduction in weekly payments would be relatively small in absolute terms. These effects will also be mitigated by the staggered introduction of the cap.

Benchmarking costs

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

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

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

79. We expect that retail buyers at these firms would each benchmark the products for which they are responsible. We estimate that it would take a maximum of 15 minutes for each product to be benchmarked and for the record of this benchmark to be retained.

80. We acknowledge that there will be significant variance in the time taken to benchmark these costs. Furniture, which is typically more bespoke, may take longer to benchmark. However, other product categories are more widely available and therefore benchmarking will take less than 15 minutes.[53]

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

82. We also assume firms incur half these costs in the first year at £160,000.

83. We expect firms to establish and implement a policy to undertake benchmarking (alongside the implementation of policies to implement the cap). We estimate the cost in the wider adjustment costs for firms in the governance and change section.

Familiarisation and gap analysis

84. Firms will need to understand the price cap so they can comply with our requirements. We use standard assumptions to estimate these costs. We anticipate that there will be approximately 71 pages of policy documentation that firms will need to familiarise themselves with. Assuming that there are 300 words per page and a reading speed of 100 words per minute, it would take around 3.5 hours to read the document. It is further assumed that 5 compliance staff at medium firms, and 2 compliance staff at small firms read the document. Finally, the hourly compliance staff salary is assumed to be £60 at the larger firms in the RTO sector, and £43 at small firms, including overheads.

85. We also estimate the cost for firms of conducting a legal review of these proposals given they are a new requirement. There are around 10 pages of legal instrument to review. It is assumed that 2 legal staff at the three largest firms in the RTO sector and 1 member of legal staff at small firms will review the legal instrument associated with the implementation of the price cap. It is further assumed that each legal staff member can review 50 pages of legal text per day. Finally, using data on salaries from the Willis Towers Watson UK Financial Services survey the hourly legal staff salary is assumed

53 We note we have done a similar exercise for the products sold by RTO companies. Our time estimate is reasonable given the time expended by FCA staff on this exercise.

to be £66 at the large firms in the RTO sector and £52 at small firms, including 30% overheads.

86. Using these assumptions, we expect total one-off industry-wide costs of approximately £10,000.

IT change

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

88. One-off IT costs are estimated using research on the structure of IT projects. We assume that the three large RTO firms each use 156 days of staff time from staff in 6 different roles[54] to update their IT systems to implement the price cap, across a project lasting 40 days. Using salary information from Willis Towers Watson 2016 UK Financial Services Report, we calculate that these changes will lead these three firms to incur costs of £56,000 each.

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

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

Governance and change

91. The proposed cap is likely to lead firms, especially the large firms, to set-up a project team to ensure their compliance with the cap. For example, we might expect firms to change or revise their internal processes to ensure they comply with the cap. We would also expect firms to develop policies and procedures to set out how they will comply with the cap in practice, including how they will undertake and record their benchmarking. The model captures the estimated cost of such changes through 'change projects', which principally estimate costs on the basis of time incurred by a project team and project management, including senior staff time. We use existing internal data from research undertaken by the FCA to understand this type of project to estimate these costs.

92. We expect that the larger firms would on average spend 280 days to deliver the changes required of the business to meet the cap. The time is spread across project teams and executive and board oversight. We would expect in practice that firms would incur less time in developing their compliance with cap. We might expect that firms reconsider their business models as a result of the cap. We do not account for these costs as changing business models would reduce the impact on firms' revenues we estimated above.

93. Using salary information from Willis Towers Watson, to estimate the salaries and applying a 30% overhead, we estimate the average cost of the 3 large firms to be £100,000 per firm.

54 Business analysis team, Design team, Programming team, Project management team, Test team, Senior Management

94. We would expect firms to incur these costs from the time of publication of any subsequent Policy Statement setting out final rules until the end of the transition period, currently planned to end at the start of July 2019.

95. For smaller firms, we expect the costs to be much less. We expect firms on average to devote 18 days, which would lead to a cost of £2,000 per firm.

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

Consequences for consumers that lose access to RTO

97. As noted above, we estimate that less than 5% of consumers who would otherwise receive RTO agreements would not be approved as a result of firms changing their approval practices in response to a cap. For the purposes of quantifying these impacts, we are assuming the impact is 5%.

98. Based on the experience of rejected RTO applicants that we surveyed, we estimate that half of consumers who lose access to RTO, i.e. 2.5% of all customers, would not access the product from an alternative source. We consider the effects on consumers who lose access to RTO but obtain the good elsewhere, most likely at lower cost, in the section on consumer benefits.

99. We would expect that consumers choosing to purchase a good value it at more than the price they need to pay; that is why they make the purchase. This difference – the amount by which consumers value the good over and above the price – is referred to as "consumer surplus." So, to estimate the costs to consumers who lose access to RTO and do not purchase the product elsewhere, we estimate the amount these consumers would be willing to pay for the average RTO product over and above the amount they would have paid if they had purchased the item using an RTO agreement. That is, we calculate the consumer surplus for this group. To do this, we use firm data on revenues, costs and volumes to calculate the 'Lerner Index'. The Lerner Index is a measure of market power and enables us to calculate the elasticity of demand at the quantity demanded.

100. Assuming a linear demand curve, we can estimate the whole demand curve and therefore measure the difference between willingness to pay and amount paid for all consumers. This is inevitably an estimation, but it is a reasonable approach to take in trying to quantify the impact of loss of access to RTO.

101. We are concerned, however, that measuring consumer demand using the total cost of RTO agreements overstates true demand. As noted above, consumers focus on weekly price to a much greater extent than total cost (see paragraph 25). We do not have precise information on how much this distorts consumers' demand for RTO products. We previously noted that consumers appear to underestimate the total costs of their RTO agreements by 15%, on average. While this does not necessarily show that they underestimated total costs by this amount at the time of their purchase, it does provide some measure of the magnitude of the distortion that may be caused by consumers' narrow focus on the weekly payment amount. As an approximation of the impact of this effect, we shift the demand curve down by 15%. However, given the uncertainty here, we create an upper bound of these costs assuming that the demand we observe is the true demand. That is, we undertake the analysis without shifting the demand curve down by 15%.

102. This shift means that some consumers are paying more than their true willingness to pay and buying a RTO product makes them worse off, and therefore benefit from the loss of access to RTO even though they do not purchase the product they were seeking. We report these benefits separately in the benefits section.

103. We use two approaches to estimate the impacts of the loss of access to RTO on consumers. As noted above, around half of the consumers in our survey who were declined by RTO providers managed to access the product from another source. We might expect that consumers who do manage to obtain the good somewhere else attach a higher valuation to the product than those who do not. If this is true, the cost of losing access to the good, for those who do not obtain it elsewhere, is lower, and the likelihood that a consumer benefits from avoiding an RTO agreement is higher.

104. We note this is uncertain and hence we estimate a range of impacts – one where we assume that the consumers who do not obtain the good are a random selection of those who lose access to RTO and one where we assume that they are the consumers who value the product least.

105. Using these two approaches, we estimate the range of costs of lost access to RTO to these consumers is £220,000-2,800,000 per year.

Search costs for finding products elsewhere

106. We estimate that half of the consumers not served by RTO firms as a result of the price cap would obtain the goods elsewhere. In the survey we undertook of consumers, we asked consumers who were rejected for an RTO product but who subsequently managed to source a product how much effort this took. Only a minority of consumers suggested this was more than a little effort. Around 18% stated that this was a lot of effort.

107. To estimate the costs of searching, we value an individual's leisure time based on the Department for Transport's analysis and modelling. This provides an hourly value of £5.70 per hour (2018 prices).[55] We assume that all declined consumers spend 1 additional hour looking for their product.

108. In total, we estimate that additional searching costs consumers £120,000 per year.

FCA costs

109. Supervising these additional rules will be undertaken using existing resources. The cost arises through the reduction in supervisory time allocated to other activities because of this additional requirement. We expect that supervising the price cap would take less than 0.5 FTE at an average salary of £50,000-80,000. This would imply a total cost to the FCA with 30% overheads of less than £50,000 per year.

Benefits

Consumers

110. Consumers will benefit primarily by paying lower costs on their RTO agreements. In addition, some consumers who lose access to RTO agreements may benefit, either by

55 See https://www.gov.uk/government/publications/webtag-tag-data-book-may-2018, A.1.3.1

purchasing the goods elsewhere at lower cost or because they avoid purchasing items via RTO at total costs greater than that which they place on the goods.

Lower prices of RTO goods

111. The benefits to consumers arise mainly from paying lower prices for products purchased using an RTO agreement. The savings to consumers are equal and opposite to the revenue firms lose on sales they continue to make. We calculated these in the section on the revenue costs to firms.

112. We find that the saving to consumers from the proposed price cap for those that continue to purchase through RTO would be £17.9m per year.

113. We would expect that, as well as there being price savings for those consumers that would buy regardless of whether the cap is brought in, there are two other groups of consumers that would potentially buy from the RTO provider as a result of the lower prices. Firstly, the lower prices will potentially attract consumers to buy RTO products when previously they were deterred by the price. Secondly, consumers that were previously found not to be able to afford agreements may now be able to afford the RTO products.

114. As we noted above, firms would gain these additional sales. We don't believe it is reasonably practicable to measure the size of additional benefits to consumers as we do not have the data to assess the profitability of these consumers and therefore the extent to which additional sales would be made.

Purchase of lower price alternatives

115. As noted above, our survey of consumers who were denied an RTO agreement showed that around half of them found an alternative product. We therefore expect around 2.5% of consumers who are denied an RTO agreement as a result of the cap to find an alternative product. In most cases, consumers denied an RTO agreement did not use consumer credit to access these products. Rather, they accessed the product using other means.

116. In our survey, only 15% of respondents said they used a credit product to purchase their product. We apply this 15% to the 2.5% of consumers who find alternative products. We might expect that some consumers used their household budget to purchase their product and hence they were short of money in the period after purchase. They may have then borrowed subsequently to make up the money spent on the product. However, we do not think that a significant number of consumers will be able to access credit and we therefore think the 15% of consumers is a reasonable estimate. We also expect that consumers using alternative credit source to fund their product purchase are likely to do so more cheaply. We therefore underestimate the benefits of those who use alternative credit to purchase their product.

117. We would expect in most instances that that any alternative product is much cheaper than using a RTO product. In our pricing analysis, we found that on average the total cost of purchasing using RTO is 2.7 times more expensive than buying the product using a typical high street retailer.

118. To be conservative in our estimates of benefits, we assume that consumers who purchase their product using an alternative source of credit do not make savings. This is because we would expect consumers who use alternative sources of credit would pay high levels of interest.

119. We estimate the savings on alternative purchases for consumers to be £4.6m per year. This derives entirely from those consumers not using credit to make these alternative purchases. We also expect non-RTO firms to make additional net revenue of £1.0m per year from these sales.

Benefits to consumers that avoid purchasing

120. In the section on consequences for consumers that lose access to RTO we set out our methodology for estimating the cost to consumers who lose access to RTO. As noted in that section, some consumers are harmed by the loss of access to products. Other consumers, however, who do not access the product somewhere else may be better off. These are consumers who value the product at less than the total cost of an RTO agreement, and therefore would be better off not buying that product at all rather than buying it using RTO. We estimate the benefits to these consumers by using the demand curve we calculated for consumers who lose access to their RTO products as a result of the cap.

121. As in the section on the costs to consumers of losing access, we used two approaches here. The first is to assume that the consumers who do not access the product elsewhere value the products the same as those consumers who do access the product elsewhere. The second is to assume that the consumers who access the product elsewhere are those consumers who place the greatest value on the products.

122. Using these two approaches, we estimate the benefits to consumers avoiding buying products they value below the price of an RTO agreement to be £0-510,000.

Distributional considerations

123. We note that a major impact of the cap is a transfer from firms to consumers. However, as we noted in our section on harm, these consumers are some of the most vulnerable in our society and have very low levels of income. Given that the value of an additional pound of income is higher for lower income recipient than higher income recipients, we weight these benefits using the methodology set out in HM Treasury's 'The Green Book'.[56]

124. We asked consumers for their income in our survey. We also asked questions on whether they had a partner and dependent children. We use this to calculate equivalised income, which takes into account the number of people within the household.[57]

125. Using the ratio of the median equivalised income of RTO holders to that of households in the population, and following the method in the Green Book, we calculate a weighting for costs and benefits affecting RTO users of 1.60. This implies it is reasonable to weight RTO consumers' costs and benefits at £1.60 for every £1.

56 See HM Treasury, The Green Book: Central Government Guidance On Appraisal And Evaluation, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/685903/The_Green_Book.pdf

57 We note we have taken a conservative approach to calculating the weightings used in this analysis. Firstly, we assume respondents are at the top of each band of income in their survey response (e.g. if a respondent said their household income was between £12,000 and £18,000 per year we assumed their income was £18,000 per year). Secondly, our survey responses do not necessarily identify all household members but rather partners and children under 16 years of age. This will mean that when equivalising income, we will not adjust income downwards less than we would if we had fuller information about the RTO consumers household. We note there is a countervailing impact in that some of the survey respondents did not report their income and these respondents may have higher incomes.

126. The total net consumer benefit from our proposed cost cap is £19.6-£22.7m. For the weighted benefits to be greater than the weighted costs, we would need to use a distributional weight of at least 1.45. This analysis uses the out lower bound estimate of the ongoing net benefits of the cost cap. That is, the difference between the lower bound estimate of the benefits and upper bound estimate of the costs. The calculated number is below the level implied by our analysis of equivalised income. This implies that, taking the low incomes and vulnerability of consumers into account in our analysis, the benefits outweigh the costs.

The potential for firm exit

127. We believe we have set the cap to enable firms to continue to exist in the market. We note, however, that firms in the sector are currently undergoing substantial changes (including the largest two firms making significant losses) and therefore firm exit is a possibility.

128. If firm exit were to happen regardless of a price cap, it should be considered as a change to the baseline and not an effect of the cap. This might affect the value of RTO sales in the baseline and hence the size of the impact of the intervention, but we have no reason to believe that it would have a disproportionate impact on the costs over the benefits. We do not therefore think this would materially change the implications of our CBA.

129. There is the possibility, however, that the price cap itself, and the associated reduction in firms' revenue, could be considered the cause of a firm exiting the market in the future. We assess the impact of such firm exit here.

The impact of exit

130. The impact of exit from the RTO market on a firm, and its owners or investors, would be the loss of future profit from the firms' RTO operations and the costs of winding up the business, if the firm were to close entirely. To consider a cap the cause of firm exit, the impact of the cap must make a profitable firm unprofitable. That is, the reduction in profits from the implementation of the cap must be greater than the firm's expected profits. This means that a firm's profits are smaller than the revenue costs we estimated in the section on loss of revenue and profits. Consequently, our estimates of the costs to firms under the assumption that they continue in operation should be considered an upper bound estimate of the costs to firms if they exited, apart from the costs of winding up the business if the firm were to close entirely.

131. We note that some smaller RTO retailers may exit the RTO business but continue to operate in other consumer credit markets or continue to operate as retailers (following winding down their credit activity). We note in these instances the costs to firms to wind down the RTO element of their business (over and above the revenue impacts described above) would be minimal. This would be the most likely approach, rather than winding up, that RTO providers would take in response to challenging market conditions (for example, we note that one provider recently moved most of their business online), so we do not therefore consider it is reasonably practicable to consider the costs of winding up an entire business.

Impacts on access to RTO agreements

132. The impacts on consumers of a firm exiting would depend on the business model of the firm exiting as well as the business model of any firms remaining in the market. While the three largest RTO firms all operate businesses online, only the largest operates a large network of physical stores.

133. If a firm operating primarily online were to exit, consumers would likely still be able to access RTO through other providers. There may be some loss of access if underwriting standards differed across firms, or simply because consumers were unaware of alternative providers.

134. The impacts of a loss of access would be similar to the loss of access from firms no longer offering agreements to some customers. Some customers would benefit from finding less expensive ways to purchase items. Some would benefit from avoiding costly RTO agreements even though they would not obtain the good they sought, and some would be harmed because they valued the good at more than the cost of using RTO. Which of these effects dominates, and whether consumers who do not obtain the product are made worse off or better off, on net, depends on assumptions about whether they are the consumers who value the product the least.

135. Based on our analysis, we do not believe that the price cap would lead to the exit of the lead provider of RTO.

136. Given the size of the revenue effects on firms, we do not expect exit by firms that would seriously curtail the ability of consumers to access RTO retailers.

Impacts on existing customers

137. In the event of firm failure, there may be some consequences for existing customers.

138. Consumers may lose their ability to return items where they have been damaged and hence they lose the equity they have built up in the product. However, we do not think this will affect a large number of consumers.

139. Consumers pay for extended warranty cover either on a weekly basis or as a financed component of the agreement. Where a firm goes into administration, existing customers may be able to continue paying for their extended warranty. Few consumers would lose out on cover for a warranty for which they had already paid.

140. Where consumers pay in store, consumers may face difficulties if the option to pay in store is taken away. This is because RTO consumers may not be comfortable or have access to more mainstream ways to pay. We note that this also affects store closures as well as firm closures. We do not believe this effect is significant, however.

141. We note that recently an RTO retailer has gone into administration. We do not observe the types of problems described above arising in this situation.

Overall impacts of firm exit

142. The primary impact of a firm exiting on the cost benefit analysis would be through the implications for consumers who lose access to RTO agreements. As noted above, this loss of access, barring exit by the largest firm, would likely be quite minimal. In addition, the impacts on consumers of losing access to RTO agreements are mixed, and could well be positive. Given this, the potential for firm exit, especially when that exit is by no means certain, does not significantly affect our overall evaluation of the costs and benefits of the proposal.

143. Firm exit may also lead to the wind-up of firms, or significant changes in business models to exit the RTO sector. Given the uncertainty inherent in predicting firm exit, we do not believe it is reasonably practicable to estimate these costs.

144. The exit of one or more firms from the market could also have an impact on competition. Any impact on competition will depend on the specific firms that exit and the number of firms that exit as a result of the proposed cap. We would not expect there to be a significant impact on competition between the remaining firms following firm exit, and we therefore do not expect a significant impact on prices from any such exit. This is because relatively few consumers refer to other RTO firms as an alternative source of their product.[58] Consequently, in the event of exit of a firm we might not see large amounts of diversion to other RTO firms. Even if we saw significant diversion to the remaining RTO firms, and these RTO firms sought to raise their prices from reduced competition, the imposition of the proposed cap would act as a constraint from increasing prices. It is possible that remaining firms will reduce service levels as a result but we do not think there is currently strong competition on service levels that would be diminished as a consequence of any firm exit.

Q8: Do you agree with our assessment of the costs and benefits of these proposals?

58 We note that only 1% of RTO consumers in our survey considered using an alternative RTO retailer. Further, of those declined only 5% bought from another RTO retailer and of those that decided not to proceed with an RTO purchase only 2% purchased from a different RTO retailer. This suggests that the majority of consumers would not buy from another RTO retailer following firm failure. This would especially be the case where consumers purchase through stores and there is not an alternative RTO retailer in the local area.

Annex 3
Feedback to CP18/12 on price cap

1. A large majority of respondents to the DP were in favour of some form of intervention to address pricing in the RTO sector with many favouring a price cap of some kind.

2. Most of these respondents identified that in order to address harm from high prices effectively we must address the high cash prices at which many RTO firms sell products. Options put forward included requiring firms to benchmark against recommended retail price (RRP), or prices for similar products sold elsewhere. Some offered more detailed thoughts on how compliance might work (e.g. requiring firms to report to us their top selling products with average prices of comparable goods).

3. Where respondents expressed a view on the appropriate level of the cap they argued for a total cost cap of 100% of the total amount borrowed. Many argued that a daily or monthly interest rate cap would also be required to prevent RTO firms from increasing the prices of shorter term agreements.

4. Responses in favour of a price cap generally argued that charges associated with delivery, installation and missed payments should also be subject to controls to limit harm to consumers. These ranged from inclusion in a broader total cost price cap, individual capping levels, and more general restrictions (e.g. point-of-sales bans on add-ons). Most of these respondents considered that the price consumers pay for theft and accidental damage cover should be addressed outside of any price cap.

5. By contrast, responses from RTO firms emphasised the potential negative consequences to consumers and the market which could arise from a price cap. These included:

- A reduction in credit supply would have negative impacts on consumers, as RTO is used for provision of major household items rather than discretionary expenditure (unlike HCSTC)
- Consumers have very few alternatives to using RTO; delaying purchases or going without items is likely to have negative consequences e.g. increased costs or social stigma
- The low levels of industry profitability mean that a cap could lead to firm exit and loss of consumer access and choice. Firms have fixed costs (e.g. store network) which make it impractical to reduce prices
- There may be significant potential compliance costs for firms meeting the definition of an RTO firm even where a price cap may not impact due to lower prices.[59]

59 For instance, one firm told us they may need to monitor the prices set by other retailers for a range of more than 2000 products.

6. Firms also highlighted the challenges of designing and implementing a price cap, given the complexities of the RTO business model and the costs associated with it. In particular they argued that:

- there are few readily available benchmarks for setting base price, given that RRP is not provided for all products. White label and own-brand goods and bundles cannot be easily compared with other retailers.
- the dynamic nature of pricing means that where other retailers change their prices this may lead to non-compliance even where firms have set prices in line with any potential cap in good faith.
- RTO firms operate a different business model to most other retailers, which drives the difference in pricing. E-commerce firms for instance may have different capital market profitability requirements, and large high street retailers enjoy lower acquisition costs for products due to volume.
- Controlling base prices could limit the supply of goods to consumers and impact the supply chain. The margins that retailers make vary significantly according to the retailer, and the level of service they provide.
- It is not practical for any one retailer to have the minimum price across all products, and pricing should be examined against a standard basket of retailers or a particular benchmark retailer.
- Any total cost of credit cap could lead to the introduction of interest rates that differ by term, with price increases for shorter terms.
- Inclusion of insurance add-ons may lead to reduction in provision of these items, and they should be considered as a product in their own right. These products are valued by consumers and costs to consumers of lack of coverage can be significant.
- Firms may react to a price cap by changing their product offering (e.g. moving into consumer hire) which may have greater risks.

7. Many respondents put forward alternative solutions for addressing harm for high prices, with some arguing these should be taken in combination with a price cap. They included:

- Better creditworthiness checks and information sharing between lenders
- Promotion of debt advice and affordable credit
- Limits on how many RTO agreements a consumer can hold at one time
- A cap on how much consumers can borrow against their net weekly income
- Limits on the contractual length of RTO agreements
- More transparent pricing to allow for comparison with other retailers on cash pricing. This could be driven by improved coverage on price comparison websites or including other retailers on the website of RTO firms

- Providing comparisons with the costs associated with other credit providers
- Firms working with social housing providers to offer lower cost access to appliances supported by credit guarantees
- Preventing firms from selling exclusive product models to allow for easier price comparison
- Banning the sale of add-on products or measures to increase awareness of alternatives.

Annex 4
List of non-confidential respondents to CP18/12

**RTO and alternatives to high-cost credit only*

Advice NI

Alan Campbell

Brighthouse

Cambrian Credit Union

Capital Credit Union

Carnegie UK

Centre for Responsible Credit

Chartered Institute of Credit Management

Christians Against Poverty

Citizen's Advice

Citizen's Advice Scotland

Citizen's Advice Swansea Neath Port Talbot

Debt Camel

Domestic & General

End Child Poverty

Experian

Financial Inclusion Centre

Financial Services Consumer Panel

Irish League of Credit Unions

Leeds City Council

Leeds City Credit Union

Money Advice Service

Money Advice Trust

Money and Mental Health

Mutual Clothing Company

MoneySavingExpert

National Credit Union Forum

Perfect Home

Responsible Finance

Scotcash

Skyline Direct Limited

Smarterbuys Store

StepChange

Taxpayers Against Poverty

The Debt Solutions Consultancy

Yvonne Fovargue MP

Annex 5
International comparisons

1. In CP18/12, we committed to looking at international examples to help inform our analysis of whether an RTO price cap is appropriate and its potential impact. This note summarises what we have learned.

European Union Member States

2. Feedback from national authorities suggests that: a) RTO is not common across all member states (the Czech Republic, Denmark, Finland have no discernible RTO market); b) an RTO market exists and is regulated, but is not subject to any price controls (e.g. Ireland, Lithuania, Sweden); or c) RTO is subject to a price cap that applies across all higher cost credit (e.g. Latvia, Portugal).

Australia

3. 'Consumer leasing' (a leasing arrangement where a consumer does not have a right or obligation to purchase the product at the end of the term) can be high cost. There are no price controls in place currently. Some lessor firms can charge consumers significant amounts, even when purchasing goods at retail prices before leasing them to consumers. The main sources of harm are often to vulnerable consumers who experience financial difficulty, including becoming unable to meet their basic needs or defaulting on other commitments, after entering into a consumer lease. Consumer lease contracts often extend for a number of years.

4. The Government drafted legislation[60] to cap:

- Lease costs to the consumer (interest and the cost of add-on products or services, apart from permitted delivery and installation fees) at 4% of the base price of the leased product for every month of the agreement up to a maximum of 4 years (consumer leases will be able to extend beyond 4 years but the lessor will not be able to charge more than the equivalent of 4% of the base price a month over 4 years). High-cost short-term credit in Australia is already capped in a similar way.
- Base prices at the lower end of the recommended retail price / 'fair market value' or the purchase price.
- Lease payments up to 10% of a consumer's net income.

5. ASIC (the Australian Securities and Investments Commission – the regulatory authority responsible for supervising the legislation) will have responsibility for supervising compliance with the cap – including the 'fair market value' of a base price.

60 https://static.HM Treasury.gov.au/uploads/sites/1/2017/10/c2017-t229374-Exposure-Draft.pdf

6. The timing of the legislation is currently unclear however firms will be given 12 months to implement it once enacted.

United States of America

7. RTO falls largely outside of US federal jurisdiction, but RTO-specific legislation at the state level dates back to the 1980s. State legislation tends to be focused on pre-contractual disclosure.

8. A small number of states also cap prices – eg 'base price to wholesale price' (with different ratios depending on product type) and 'leasing costs to base price' ratios.

9. West Virginia also allows RTO firms to set base prices along several other different lines, including: the actual cash sales of new and used goods, benchmarking against other retailers (although there may be limited incentives on RTO firms to use this method); and methods accounting for the book value and depreciation of used goods.

Annex 6
Simulating revenue impacts

Introduction

1. This Annex sets out our approach to estimating the effects of the cap on firms' revenues and on their willingness to offer agreements.

2. The cap will reduce firms' revenue through the effects of:

- benchmarking base prices
- the total credit cap

3. To estimate the effects of benchmarking on RTO firms' base prices, we compare individual RTO firms' published prices with mainstream retailer's prices (see Annex 8). We assume that, as a result of benchmarking, RTO firms' product prices will be no more than 10% above the median price we observe at other retailers. To implement this, we use the averaged difference between prices at each particular firm and other retailers at the product category level (e.g. appliances).

4. The cap may also affect firms' willingness to offer agreement to some applicants. The reduction in the revenue from the cap will lower the expected profitability of some agreements (that is, the profit the firms expect to make on the agreement, given their expectations about repayment and return behaviour). This may mean that the expected profitability of some agreements declines to the point where a firm is not willing to approve an application for an agreement.

5. We use detailed payment-level data provided by the two largest RTO firms to conduct these simulations.

Simulating revenue impacts

6. We simulate revenue impacts using the most recent financial year of payment data (2017-2018). We take the sum of all payments made over the course of that year on all agreements that were active in that year, regardless of when they began. We then calculate what the revenues on each of those agreements would have been if the cap had been in force when the agreement was opened.[61] The estimated revenue impact is the difference in the actual and the simulated revenues.

7. We use two approaches to simulate the revenues that would have been due if the cap had been in place. The first is to assume that firms would not have changed their pricing in response to a cap, and therefore the only difference in the revenues is that

61 The revenues from warranty, insurance are not subject to the cap and therefore remain the same.

which comes from the effects of benchmarking the product price and capping the cost of the financing.

8. The second approach is to assume that firms would raise interest rates to keep the revenue on individual agreements as close to current actual revenue as possible. To implement this, we calculate the revenues that would result with the product price adjusted to reflect benchmarking and the interest rate set to the level that would result in a total financing cost equal to the cost cap. If this is above the actual revenue before the cap, the actual revenue is used (implying revenue is unaffected by the cap). If this is below the actual revenue, this simulated revenue is used, reflecting a partial recovery of the revenue.

Simulating impacts on the willingness of firms to offer agreements

9. We estimate the effect of the cap of firms' willingness to offer agreements by assuming that firms will not offer agreements with an expected net revenue below that of their least-profitable current agreements. We determine this by measuring the expected net revenue of customers based on the firms' internal credit scores.

10. Net revenue is calculated as revenue minus the cost of goods sold. To calculate the cost of goods sold, we take a proportion of net book value assuming a straight-line amortisation over the life of the agreement. For active agreements or agreements that has the good returned, the proportion is calculated as a ratio of total number of weeks this agreement is active in the period of consideration and total number of weeks in the term of that agreement. For non-active agreements, the proportion is calculated as a ratio of total number of weeks to maturity including total number of weeks this agreement is active in the period of consideration and total number of weeks in the term of that agreement.

11. We first divide consumers up into 20 equal sized groups based on firms' internal credit scores.

12. We then calculate the average net revenue, by credit scoring group, for agreements that were opened early enough that they would have been complete by the end of the period covered by the data. We calculate actual net revenue, as well as the potential net revenue that would have been earned by the firms if the customer had made all payments as scheduled. We then calculate the ratio of actual to potential net revenue at the agreements level and take the average ratio for each credit score group.

13. Using the average ratio of actual to potential net revenue, we then estimate the expected net revenue of agreements taken out in the most recent financial year of the data.

14. We use this to establish the lowest level of expected net revenue that the firms would be willing to offer an agreement.

15. We then estimate expected net revenue for the most recent financial year of the data using the revenue firms would earn if the cap had been in place, using the methodologies and assumptions described in the previous sections.

16. We then compare the average simulated estimated net revenues for each of the 20 credit score groups with the average estimated net revenue for the lowest credit score group.

Annex 7
Availability of alternatives to RTO

Introduction

1. This Annex sets out our approach to analysing availability of credit alternatives for RTO users.

2. We look at whether existing RTO users could move their debt onto other forms of unsecured credit. These include unused limit in pre-existing credit cards or arranged overdraft lines as well as credit that these consumers could reasonably obtain if they applied.

3. Specifically, in this analysis we estimate whether each RTO user could move their RTO debt on to:

- Available limits on existing credit cards or arranged overdraft lines, as observed in the CRA data; or
- Available limits on existing credit cards or arranged overdraft lines plus an estimate of the additional unsecured credit they could get if they applied.

4. In this analysis, we only consider credit that would be available to consumers in addition to their existing credit, rather than retrospectively estimate how much consumers could have borrowed had they not used RTO in the first place. This means that our analysis of available alternative is rather conservative.

5. The rest of this Annex first presents the data used for the analysis, and then describes the methodology and key findings.

Data

6. To estimate credit alternatives available to RTO users we use the credit holdings position, credit score and income as of January 2017, and the application and product opening activity in the credit markets in the first three months of 2017. We obtained this information from the Credit Reference Agency (CRA) data.

7. The CRA data consists of a main dataset containing monthly snapshots of the credit position of a random sample of around 10% of the adult UK population and their financial associates. This is supplemented by information on personal characteristics, including credit score and income, as well as information on product applications.

8. The CRA data is described in two previous FCA publications:

- The High-cost credit review technical annex[62] explains how these data are constructed; and
- Chapter 4 of the Occasional paper 28[63] sets out in more details data limitations.

Our approach to estimate total unsecured credit available

9. The total unsecured credit accessible by each RTO user is obtained by taking any unused pre-existing credit card or arranged overdraft limit (observed in the data) and adding on an estimate of how much additional credit each consumer could obtain (estimated).

10. For a given RTO user, the additional credit available is estimated by observing how much credit other consumers with similar characteristics have obtained in the credit markets over a short period. This includes both new credit and limit extensions on existing credit cards and arranged overdraft lines. Since consumers do not necessarily apply for the maximum amount of credit they would be eligible for, we use a quantile regression approach to estimate additional credit: instead of estimating the average amount of additional credit obtained by people with similar characteristics, we estimate the upper end of the distribution of the amount of credit people with similar characteristics obtained.

11. Our methodology to estimate additional credit can be summarised into three main steps:

- Calibrate models using data on consumers who applied for credit;
- Validate models on held-out data to pick the one with the best fit; and
- Predict the additional credit that each consumer using RTO could have got if they applied.

12. We discuss these in turn in the sections below.

Model specification

13. The dependent variable is the observed additional unsecured credit (excluding RTO products) obtained by all consumers in the CRA sample who applied for a credit product between December 2016 and March 2017 or obtained credit between January 2017 and March 2017. We include customers who applied for new credit but did not obtain it to ensure we capture cases where no credit was available to consumers.

14. We control for the following characteristics, all observed as of January 2017:

- Past behaviour, captured by a consumer's credit score; and

62 Financial Conduct Authority (2017) High-cost credit review technical annex 1: Credit reference agency (CRA) data analysis of UK personal debt. See: https://www.fca.org.uk/publication/feedback/fs17-02-technical-annex.pdf

63 Financial Conduct Authority (2017) Preventing financial distress by predicting unaffordable consumer credit agreements: An applied framework. See: https://www.fca.org.uk/publication/occasional-papers/op17-28.pdf

- Affordability, captured by:
  - Income;
  - Committed repayments on all existing credit products;
  - Total limit on existing credit products; and
  - Total balance on existing credit products.

15. We use the raw data as contained in the CRA dataset. This is consistent with the information that would have been available to a firm performing a credit or income verification check. This is not perfect, as some firms may have access to additional data that we do not observe.

16. The model is estimated on applicants only. This will introduce a selection effect to the estimation because the choice to apply will not have been random—however, those who apply for credit are generally less creditworthy than the population as a whole, and therefore we expect our estimates to be conservative.

17. In constructing the dependent variable, we only consider additional credit obtained within a maximum of 90 days from when we observe their credit score and estimated income. This is to ensure that consumers' credit scores and incomes at the time we observe outcomes in the market are unlikely to have changed substantially, but also allows us to capture a much larger sample of successful and unsuccessful applicants than looking at one month alone.[64]

18. In constructing the dependent variable, we only consider additional credit obtained within a maximum of 90 days from when we observe their credit score. This is to ensure that consumers' credit score at the time we observe them in the market is unchanged.

19. We train the model on a random sample of 90% of the consumers in our sample, testing several methodologies: linear quantile regression (with and without interaction terms), penalised quantile regression (with and without interaction terms), and a quantile random forest.

Model validation

20. For our purposes, we care about accurately estimating what credit consumers could get if they applied. We are not interested in the precise relationships between input variables and the outcomes, we are only interested in maximising the accuracy of our estimated outcome.

21. As a result, we validate the models by testing their in-sample fit, and their out-of-sample fit on the remaining 10% random sample of the available data. We benchmark the models performance using the R1 measure of goodness of fit developed by Koenker and Machado (1999).[65] We find that quantile random forest model performs substantially better than the alternatives both on the in-sample and out-of-sample measures.

64 We have compared the credit score and income in January 2017 to that in January 2015 (which is the only other month for which this information is available in the CRA data) and found that for most of the population, both credit score and income are stable over the two years. This supports our analysis' assumption, where we assume that credit score and income are stable over a 3 months period.

65 The R1 measures goodness of fit by comparing the sum of weighted deviations for the model of interest with the same sum from a model in which only the intercept appears. See: Koenker R. & Machado J. (1999) Goodness of fit and related inference processes for quantile regression, Journal of the American Statistical Association, 94. pp. 1296-1310.

22. The quantile forest approach has other desirable properties in this context. It estimates quantiles using an empirical distribution of the credit similar consumers actually received. This results in realistic estimates of the amount of credit consumers could actually get. For example the model picks up that credit is typically issued in round numbers, with smaller increments closer to zero and larger increments further away from zero.

Prediction of additional unsecured credit available

23. We use the quantile random forest model to predict the additional credit available to RTO users in January 2017. We choose estimates of additional credit at three percentiles:

- 80th percentile: 1 in 5 applicants with similar characteristics got *more* additional credit than this amount;
- 90th percentile: 1 in 10 applicants with similar characteristics got *more* additional credit than this amount; and
- 95th percentile: 1 in 20 applicants with similar characteristics got *more* additional credit than this amount.

Key findings and conclusions

24. We find that 3% of RTO users could move their RTO debt onto available limit in existing credit cards or arranged overdraft in full, and 4% could move half of their RTO debt.

25. Once we take into account our estimates of the additional credit consumers could get if they applied, these proportions increase substantially: around 15% of them could borrow enough to move their entire RTO debt onto other credit products, and almost 1 in 4 could move half of it. This is a significant proportion, especially considering that most products available through RTO could be purchased in the open market for half the price.

Table 1: Share of RTO users with a credit alternative

How many RTO users would have been able to avoid RTO thanks to:	Available limit in existing credit cards or arranged overdraft lines	Total available unsecured credit = Available limit in existing credit cards or arranged overdraft lines + Estimated additional credit available.		
		80th quantile	*90th quantile*	*95th quantile*
All RTO users	3%	12%	15%	19%
All RTO users – half the balance	4%	19%	24%	28%

26. Compared to those who have alternative credit options, the consumers who would not be able to move their RTO debt on other forms of credit tend to have significantly lower credit score, but similar income.

Table 2: Comparison of RTO users without a credit alternative to those with a credit alternative

RTO users without credit alternatives compared to RTO users with credit alternatives	Available limit in existing credit cards or arranged overdraft lines	Total available unsecured credit = Available limit in existing credit cards or arranged overdraft lines + Estimated additional credit available.		
		80th quantile	*90th quantile*	*95th quantile*
Average credit score difference (in credit score's points)	-54	-38	-36	-33
Average income difference	1%	0%	-3%	-4%

Annex 8
RTO pricing analysis

Introduction

1. This Annex sets out our approach gathering information on the pricing of RTO firms and the pricing of the same products at other retailers, and for making cost comparisons.

Choosing products for comparison

2. We sought to find comparable prices for a total of 50 products for each RTO firm, using the products listed for sale on their websites in the categories of home appliances, technology, and TV and audio. We ultimately searched for comparable products for most products in these categories listed on the firms' website. Refurbished items and furniture were excluded from the price comparisons.

3. For each product, we first sought price information from mainstream high street and online sellers, including Curry's, Argos, Appliance Direct, and AO. When products were not available from three of these retailers, we sought to collect information from other retailers with pricing information available online.

Gathering cost information and comparing prices

4. In addition to base price information, information on delivery and installation charges were collected. All comparisons include the cost of delivery and installation, where relevant. Some non-RTO firms also bundle disconnection and removal charges; where those cannot be un-bundled from delivery and installation they are included.

5. Cost information for financing, insurance, and extended warranties were collected by recording the weekly payment information from RTO firms' websites.

Annex 9
Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposal in this consultation to introduce an RTO price cap. This includes an explanation of the FCA's reasons for concluding that our proposal to introduce a price cap is compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by s.138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is compatible:

   a. With its general duty, under s.1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives; and

   b. With its general duty under s.1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA.

3. The FCA is also required by s. 138K(2) 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.

4. 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 (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

5. In addition, this Annex explains how we have considered the recommendations made by HM Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.

6. This Annex includes our assessment of the equality and diversity implications of these proposals.

7. 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.

8. This annex must be read in conjunction with the rest of the consultation paper and the cost benefit analysis. Collectively, these demonstrate how we have met our statutory duties.

The FCA's general duties: Compatibility statement

9. The proposals set out in this consultation are intended to advance the FCA's operational objective of achieving an appropriate degree of protection for consumers. They are designed to protect consumers from harm from using RTO products, which we have identified during the course of the high-cost credit review.

10. Our proposed price cap is intended to address harm to vulnerable consumers from the highest costs of using RTO. RTO consumers are among the most vulnerable in society, pay high prices despite their low incomes, and have behavioural biases or lack alternative options meaning their decision-making places limited restraint on the prices RTO firms charge. Our proposals will ensure that consumers never pay back more in interest than the value of the product. Our proposed requirement on firms to benchmark their prices against prices for identical or comparable products will prevent gaming of the overall interest rate cap. This will result in some consumers paying less to obtain household goods through RTO. Where there is a reduction in access for consumers using RTO we would expect this to be beneficial for some, e.g. if they decided to source products from elsewhere at lesser cost, or decided to go without a product. However, we recognise there will be a proportion of consumers who will experience adverse consequences as a result of the price cap; even if a larger number benefit.

11. In considering the degree of protection that is appropriate for consumers in this area, we have had the following regard to the matters set out in s.1C(2)(a)-(h) FSMA:

- *S.1C(2)(a) differing degrees of legal risk involved in different kinds of investment:* we do not consider that this is relevant to this proposal
- *S.1C(2)(b) differing degrees of experience and expertise of consumers:* we believe that this proposal reduces harm to consumers with limited financial capabilities who are focussed on obtaining essential goods. We have previously acted in this sector to improve price transparency to help consumers with greater experience and expertise to make better informed decisions, but don't consider that these fully address harm due to the low levels of financial literacy, lack of alternatives and/or behavioural biases of consumers.
- *S.1C(2)(c) timely provision of advice and information which is accurate and fit for purpose:* we are not proposing changes to the information given to consumers using RTO, as we do not think these would be effective in addressing the harm to consumers we have identified.
- *S.1C(2)(d) general principle that consumers take responsibility for their decision:* while we have had regard to this principle we don't consider that this diminishes the case for the proposed price cap given that: (a) the evidence shows that for many of the consumers who use RTO they are buying essential household products and have no alternative options, therefore reducing their capacity to make different decisions, and (b) that behavioural biases cause many RTO consumers to make decisions that

are arguably not in their best interests. We therefore consider a price cap necessary to protect vulnerable consumers from the high price of some RTO agreements.

- *S.1C(2)(e) general principle that providers provide appropriate level of care:* we consider that the proposed price cap will help ensure that the vulnerable consumers who use RTO are treated with a level of care that is appropriate given their vulnerability.
- *S.1C(2)(f) differing expectations of consumers:* we do not consider that this is a relevant consideration
- *S.1C(2)(g) any MAS information provided to the FCA:* we have not received any information from MAS on the issues at hand which would have impacted our proposals.
- *S.1C(2)(h) any FOS information provided to the FCA:* we have not received any information from FOS on the issues at hand which would have impacted our proposals.

12. We consider that our proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function. In particular, they seek to ensure that the market here functions in the interests of consumers by addressing the harm that vulnerable consumers are paying prices for household products that represent poor value- some as a result of behavioural biases and many in the absence of alternative options. Our proposals are not seeking to prevent consumers using RTO agreements, which we note can play a role in helping consumers obtain household products. But they are seeking to reduce the high costs consumers pay when entering into some RTO agreements. Our CBA has found that this will result in better outcomes for consumers, and that the measures we are proposing are proportionate to the harm identified.

The regulatory principles: Compatibility statement

13. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s.3B FSMA.

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

14. We consider that the proposals are compatible with this principle. We have followed a rigorous and methodical evidence gathering process that has enabled us to identify specific harm to consumers from using RTO. We are using the FCA's resources to take justified and proportionate steps to address this harm.

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

15. We have given careful consideration to the proportionality of the proposed intervention, and set out in the CBA our assessment of how the burdens and restrictions on firms fall to be balanced against the benefits to consumers. We recognise that the price cap will impose additional burdens on firms both in terms of business changes needed to comply with the proposed cap and the potential for lost revenue as a result of reduced prices. We have drafted our proposed rules in a way which provides firms with some flexibility where appropriate (e.g. by allowing firms to choose appropriate retailers to benchmark against).

16. As the consultation paper explains, we have also given detailed consideration to whether less burdensome interventions could provide an appropriate level of protection for consumers, but don't consider that this is the case.

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

17. We have had regard to this principle in developing our proposals. Given the size of the markets in question we do not think that our proposals will have an impact on sustainable growth in the UK economy in the medium or long term.

The general principle that consumers should take responsibility for their decisions

18. As above, while we have had regard to this principle we don't consider that this diminishes the case for the proposed price cap given that: (a) the evidence shows that for many of the consumers who use RTO are buying essential household products and have no alternative options, therefore reducing their capacity to make different decisions, and (b) that behavioural biases cause many RTO consumers to make decisions that are arguably not in their best interests. We therefore consider it necessary to protect vulnerable consumers from the high price of some RTO agreements. We have previously acted to ensure consumers are given greater transparency on the costs of using RTO which may have led to some consumers accessing goods through other means. However our proposals recognise the fact that many consumers by virtue of their low credit scores do not always have alternative options, and that behavioural biases can impact the decision making capacity of vulnerable consumers.

The responsibilities of senior management

19. We do not consider that this principle is relevant to our proposals as we do not create or affect any responsibilities directly placed on senior management.

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

20. This principle is not relevant to our proposals as they do not involve any requirements imposed under FSMA, nor do we require them to publish additional information.

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

21. In the development of our proposals we have had regard to the need to act as transparently as possible. We have published regular updates on the findings of our review of high-cost credit since the November 2016 Call for Input. We have regularly engaged with the main RTO firms on our work since announcing our intention to conduct further work on whether to consult on a price cap in May 2018.

Financial crime

22. 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 s. 1B(5)(b) FSMA). We are not of the view that our proposals create any risks in this area.

Expected effect on mutual societies

23. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies. We are not aware of any mutual societies which provide Rent-to-own services. There may be indirect affects arising from our work on alternatives to high-cost credit, such as more referrals to credit unions.

Compatibility with the duty to promote effective competition in the interests of consumers

24. Our proposals are intended to fulfil our consumer protection objective. In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers. As discussed in the CBA there is limited competition in this market and we also consider that there is some limited potential for an impact on competition from our proposals, e.g. if a firm exits the market. However, we consider that any adverse impact on competition is justified by our need to protect the vulnerable consumers in this market. Taking account of the factors in s1E(2) FSMA we have had regard to:

25. *The needs of different consumers who use or may use those services, including their need for information that enables them to make informed choices:* We have previously acted to ensure consumers are given greater transparency on the costs of using RTO which may have led to some consumers accessing goods through other means. However, our proposals recognise the fact that many consumers by virtue of their low credit scores do not always have alternative options, and that behavioural biases can impact the decision-making capacity of vulnerable consumers. We are therefore of the view that disclosures to promote competition would not be effective here.

26. *The ease with which consumers who wish to use those services, including consumers in areas affected by social or economic deprivation can access them:* we have designed our price cap with the intention of limiting a reduction in access to Rent-to-own services insofar as possible. Our proposals are instead intended to limit the costs to consumers of continued access to RTO. However we recognise that some consumers may lose access as a result of firms deciding to no longer serve particular groups. Moreover we acknowledge the risk that our proposals may lead to a contraction in the market despite our view that we have set the proposed cap to enable firms to continue to exist in the market. If this were to happen we may see a reduction in competition.

27. *The ease with which consumers who obtain those services can change the person from whom they obtain them:* we do not anticipate that our proposals will encourage consumers to change RTO providers, though they may decide to get products from elsewhere, with cash or other forms of credit where available.

28. *The ease with which new entrants can enter the market:* we recognise that our proposals may to some extent deter new entrants from entering the market. However, we consider that this is outweighed by the need to protect consumers using RTO.

29. *How far competition is encouraging innovation:* we do not consider that our proposals directly promote competition or encourage innovation, but there is a possibility that new, lower cost means of serving consumers previously served by RTO will emerge and we are working to foster the growth and awareness of these.

Recommendations made by HM Treasury under s.1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.

30. We have had regard to the recommendations by HM Treasury under s.1JA FSMA about aspects of the economic policy of Her Majesty's Government that we are required to have regard in connection with our general duties.

31. We consider that our proposals are consistent with the government's policy to achieve strong, sustainable and balanced growth. We note that price and financial stability are essential pre-requisites for strong, sustainable and balanced growth in all regions and sectors of the UK economy. We have had regard to competition, growth, competitiveness, innovation, trade and better outcomes for consumers in designing these proposals. Given the small size of the market we consider that our proposals will either not impact upon these areas or that any negative impacts are outweighed by our duty to protect consumers.

Legislative and Regulatory Reform Act 2006 (LRRA)

32. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance. We consider that our proposals are:

- *Transparent* – we are following an established consultation process in making these rules and we have engaged with firms throughout our policy development.
- *Accountable* – we are seeking feedback from this CP on whether stakeholders agree with our proposed approach.
- *Proportionate* – as the CBA explains, we consider that our proposals result in an appropriate level of consumer protection, and that the overall benefits outweigh the overall costs.
- *Consistent* – our proposals aim to ensure we set consistent expectations on firms across the RTO sector.
- *Targeted* – we have identified that action is needed to apply our rules to firms providing the RTO services and designed them in a way that goes no further than necessary to address the harm we have identified.

Regulators' Code 2014

33. For the parts of the proposals that consist of general policies, principles or guidance we consider that that our proposals meet the following principles:

- *Regulators should carry out their activities in a way that supports those they regulate to comply and grow* – we have designed our proposals in a way which firms should be able to comply with and allow them to continue to offer RTO services.

- *Regulators should base their regulatory activities on risk* – we are proposing to act in response to specific risks and harm we have identified to consumers.

- *Regulators should ensure clear information, guidance and advice is available to help those they regulate meet their responsibilities to comply* – we consider that this consultation paper provides information, guidance and advice on compliance with the proposed cap.

- *Regulators should ensure that their approach to their regulatory activities is transparent* – we are following an established consultation process in making these rules, and we have engaged with firms throughout our policy development.

Annex 10
Equalities Impact Assessment

1. When exercising our functions we are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, and to foster good relations between people who share a protected characteristic and those who do not. The protected characteristics are: age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race (which includes colour, nationality, and ethnic or national origins), religion, sex and sexual orientation.

2. In discharging this duty, we ensure the equality and diversity implications of any new policy proposals are considered. This annex sets out the results of our initial assessment, explains the potential equality and diversity impacts of our proposals where we have identified them and (where relevant) sets out any steps we have taken (or will take) to minimise them.

3. This annex also updates and finalise our assessment of the equality and diversity impacts of our extended warranties proposals (which we consulted on in CP18/12). We have not received any feedback in response to that consultation which would lead us to reconsider our initial assessment, but we have learnt more about these consumers subsequently through our own research (most significantly through our consumer survey).

4. In summary, we have found that

- particular demographics are disproportionately represented among RTO users compared to the general population.
- our proposals will have a net positive impact on consumers, as set out in our cost benefit analysis, but there may be negative impacts for some, particularly loss of access.
- while there may therefore be a disproportionate impact on groups with protected characteristics compared with the wider population, we consider these impacts to be net positive.

5. We have not received any feedback in response to that consultation which would lead us to reconsider our initial assessment, but we have learnt more about these consumers subsequently through our own research (most significantly through our consumer survey).

6. Our assessment of the equality and diversity impacts of the proposed price cap is ongoing and will not be completed until we develop and publish our final policy. We welcome input and feedback from consultation respondents to help us consider further the impacts of our proposals on protected groups.

Consumer Demographics

7. Our consumer survey has enhanced our understanding of the consumers that use RTO.

8. We know that a disproportionately high number of vulnerable consumers use RTO. Our previous analysis of a large representative sample of credit reference agency (CRA) data found that they have a median income of £16,100 and a median outstanding debt of £4,300. Less than 40% of consumers have income from employment.

9. Our survey has also confirmed that RTO users are disproportionately likely to share certain protected characteristics.

10. 61% of consumers using RTO are female.

11. 24% of RTO consumers are unable to work due to ill health or disability.

12. We find that users of RTO are much more likely to be a part of a single parent household. 23% of RTO consumers are single parents of children under 16. This compares to around 9% of all households in the general population.

13. Citizen's Advice's "Wealth and Assets Survey" found that 55% of RTO consumers have dependent children, and 43% are disabled or have a long term illness.

14. The APPG into Household Debt found through information from firms that up to 78% of consumers using RTO are female, and 60% have children.

Positive impacts of proposals

15. As set out above, our analysis indicates that groups who share particular protected characteristics are disproportionately represented among RTO users compared to the general population. Given this fact, it seems reasonable to assume that both the costs and benefits of our proposals will affect these groups proportionally more than the rest of the general population.

16. Overall we consider that our proposals will have a net positive impact on these consumers by reducing the high prices paid for accessing goods. The balance of costs and benefits is set out in detail in the CBA, but some of the key points are summarised below.

17. **Consumers using RTO:** The benefits to consumers arises mainly in paying lower prices for products purchased using an RTO agreement. The savings to consumers are equal and opposite to the loss of revenue firms lose on sales they continue to make. We find that the saving to consumers from the proposed price cap for those that continue to purchase through RTO would be £17.9m per year. In addition, the lower prices will potentially attract consumers to buy RTO products when previously they were deterred by the price and consumers that were previously found not to be able to afford agreements may now be able to afford the RTO products.

18. **Consumers no longer using RTO:** We would expect 50% of consumers denied an RTO agreement to find an alternative means of buying the product, which in most cases will be significantly cheaper. This is based on our finding that 50% of consumers declined for RTO bought the good another way. We would expect in most instances that this alternative product is cheaper than using a RTO product. In our pricing analysis, we found that on average the price of purchasing using RTO is at least 2.7 times more expensive than buying the product using a typical high street retailer. We estimate the savings to these consumers to be £4.7m a year.

19. **Total consumer benefits:** The total net consumer benefit from our proposed cost cap is between £19.6m and £22.7m.

Negative impacts

20. According to our analysis of data from firms, and if firms remain active in the RTO market, we expect 5% of consumers to no longer get their RTO agreement as a result of the price cap.

21. Of the 5% of consumers who are diverted from RTO because of the cap, we expect around half of them (2.5%) to not access the product from an alternative source.

22. In the CBA we estimate the impact on those who can no longer access the product they wanted. We estimate the costs to these consumers to be £220,000 – £2.8m per year.

23. We have not identified any alternative options which would address harm to consumers from high prices. We have considered a wide range of options, including disclosure measures, but it is our view that consumers will not react to such measures. As a result, we would not see the same benefits to consumers as a price cap, including for those consumers with protected characteristics.

Q9: Do you agree with our initial assessments of the impacts of our proposals on the protected groups? Are there any others we should consider?

Annex 11
Abbreviations in this document

APPG	All Party Parliamentary Group
APR	Annual percentage of rate of charge
ASIC	Australian Securities and Investments Commission
CBA	Cost benefit analysis
CDFI	Community development financial institutions
CFO	Community finance organisation
CONC	Consumer Credit sourcebook
CP	Consultation paper
CRA	Credit reference agency
DCMS	Department for Digital, Culture, Media and Sport
DWP	Department for Work and Pensions
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act
FTE	Full-time equivalent
GAP	Guaranteed asset protection
HCSTC	High-cost short-term credit
LRRA	Legislative and Regulatory Reform Act
MAS	Money Advice Service
MHCLG	Ministry of Housing, Communities & Local Government
MP	Member of Parliament
NI	Northern Ireland
OFT	Office of Fair Trading

ONS	Office of National Statistics
POS	Point of sale
PPI	Payment protection insurance
PS	Policy statement
RRP	Recommended retail price
RSL	Registered social landlord
RTO	Rent-to-own
SFGB	Single Financial Guidance Body
TAD	Theft and accidental damage

Appendix 1
Draft Handbook text

CONSUMER CREDIT (RENT-TO-OWN COST CAP) INSTRUMENT 2019

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 (The FCA's general rules);
(2) section 137C (FCA general rules: cost of credit and duration of credit agreements);
(3) section 137D (FCA general rules: product intervention);
(3) section 137T (General supplementary powers); and
(4) 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 1 April 2019.

Amendments to the Handbook

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

Notes

E. In the Annex to this instrument, the note (indicated by "**Note:**") is included for the convenience of readers but does not form part of the legislative text.

Citation

F. This instrument may be cited as the Consumer Credit (Rent-to-Own Cost Cap) Instrument 2019.

By order of the Board
[*date*]

Annex

Amendments to the Consumer Credit sourcebook (CONC)

After CONC 5A (Cost cap for high-cost short-term credit) insert the following new chapter, CONC 5B. The text is not underlined.

5B Cost cap for rent-to-own agreements

5B.1 Application and guidance

Application

5B.1.1 R This chapter applies:

(1) to a **RTO firm** with respect to any **RTO agreement** that has been entered into on or after one of the following dates:

(a) for a **RTO agreement** that relates to *goods* that have not been offered or made available to *consumers* by the **RTO firm** immediately before 1 April 2019, that date; or

(b) for a **RTO agreement** that relates to any other *goods*, the earliest of the following dates:

(i) any date on or after 1 April 2019 on which the **RTO firm** has changed the *cash price* of the *goods* to which the agreement relates; or

(ii) 1 July 2019.

(2) to a **RTO firm** with respect to an arrangement to vary or supplement an existing **RTO agreement,** so as to supply one or more additional or different *goods* under that agreement, that has been entered into on or after one of the following dates:

(a) for an arrangement that relates to additional or different *goods* that have not been offered or made available to *consumers* by the **RTO firm** immediately before 1 April 2019, that date; or

(b) for an arrangement that relates to any other additional or different *goods*, the earliest of the following dates:

(i) any date on or after 1 April 2019 on which the **RTO firm** has changed the *cash price* of the additional or different *goods*; or

(ii) 1 July 2019.

5B.1.2 G (1) This chapter applies to all **RTO firms** from 1 April 2019. It applies in relation to the entry into new **RTO agreements** and in relation to the variation and supplementation of existing **RTO agreements** where additional or different *goods* are to be supplied under the agreement.

(2) Where *CONC* 5B.1.1R(2) applies, this chapter does not apply in relation to *goods* that had been supplied under an existing **RTO agreement** prior to the relevant date as provided in *CONC* 5B.1.1R(2)(a) and (b).

5B.1.3 G **RTO firms** are reminded that, as set out in *GEN* 2.2.1R, the provisions of this chapter have to be interpreted in light of their purpose.

Guidance on application and interpretation

5B.1.4 G In this chapter, a word or term in bold (other than in headings and titles) has the meaning given in *CONC* 5B.7.

5B.2 Prohibition on RTO firms from entering into RTO agreements

Entering into, varying or supplementing agreements: requirements as to the cash price of new goods

5B.2.1 R A **RTO firm** must not enter into, vary or supplement a **RTO agreement** where the *cash price* of the *goods* (which are not second-hand *goods*) supplied under the agreement exceeds the **benchmarked price.**

5B.2.2 R A **RTO firm** must establish the **benchmarked price** by taking the following steps:

(1) The **RTO firm** must find three benchmarking *cash prices*.

(2) A benchmarking *cash price*:

(a) must be a *cash price* at which the *goods* are currently offered or available for sale to *consumers* in the *UK*, but not by another **RTO firm** or an **associate** of the **RTO firm** establishing the **benchmarked price**;

(b) save where paragraph (3) applies, must be for the same *goods* as the **RTO firm** intends to supply under the **RTO agreement**;

(c) where paragraph (3) applies, must be for *goods* comparable, by reference to any features or characteristics of the *goods* that might reasonably be expected to affect the *cash price,* to those which the **RTO firm** intends to supply under the **RTO agreement**; and

(d) the **RTO firm** may choose one of the three benchmarking *cash prices* to be a *cash price* charged by a *firm* in relation to *goods* supplied under a *retail revolving credit agreement*, provided the other two benchmarking *cash prices* are not.

(3) This paragraph applies where, following a reasonable search of the market, the **RTO firm** has been unable to find three benchmarking *cash prices* that satisfy the requirements in paragraph (2)(b).

(4) Where paragraph (2)(d) applies, the median of the three benchmarking *cash prices* is the **benchmarked price**.

(5) Where paragraph (2)(d) does not apply, the highest of the three benchmarking *cash prices* is the **benchmarked price**.

(6) Each item of *goods* being supplied under one **RTO agreement** must be benchmarked individually except where the **RTO firm** is offering a bundle of *goods* to be supplied for one *cash price*.

(7) Where a bundle of *goods* is being supplied under one **RTO agreement** for one *cash price*, the **RTO firm** must benchmark, as described in paragraphs (1) and (2) above, against other bundles.

(8) Where a **RTO firm** reasonably considers that a particular *cash price* is so far outside the range of *cash prices* it has found that no reasonably-informed *UK consumer* is likely to pay that *cash price*, the **RTO firm** must not use that *cash price* as a benchmarking price.

5B.2.3 G (1) New *goods* are *goods* which are not second-hand *goods* and includes, for example, ex-display *goods*.

(2) The range of features which **RTO firms** might consider under *CONC* 5B.2.2R(2)(c) when identifying comparable *goods* includes brand, quality, functionality, performance, size and colour, but only where these features could reasonably be expected to affect the *cash price*.

(3) In relation to *CONC* 5B.2.2R(8), examples of cases where the *FCA* would expect a **RTO firm** to exclude a *cash price* include, but are not limited to:

(a) *cash prices* that have been set primarily for a non-*UK* market; and

(b) *cash prices* that have clearly been set in error.

Timing

5B.2.4 R A **RTO firm** must establish the **benchmarked price** for *goods*:

(1) by the time it offers to supply the *goods* under a **RTO agreement** for the first time;

(2) by the time it changes the *cash price* at which it offers to supply the *goods* under a **RTO agreement**; and

(3) no later than 12 *months* after the last time it established a **benchmarked price** under any provision of this *rule*.

Entering into, varying or supplementing agreements: requirements as to the cash price of delivery and installation of goods

5B.2.5 R A **RTO firm** must not enter into:

(1) a **RTO agreement**;

(2) an arrangement to vary or supplement an existing **RTO agreement** by the supply of additional or different *goods* under that agreement; or

(3) a **connected agreement**,

where the *cash price* for delivery and/or the *cash price* for installation exceeds the relevant **benchmarked price**.

5B.2.6 R (1) A **RTO firm** must establish the **benchmarked price** for delivery or installation of *goods* supplied under a **RTO agreement** by selecting the *cash prices* charged for, as relevant, delivery or installation of the same category of *goods* by three retailers (who must not include a **RTO firm** or an **associate** of the **RTO firm** establishing the **benchmarked price**) and taking the median of those prices.

(2) A **RTO firm** must establish the **benchmarked price** for delivery and/or installation:

(a) by the time it offers to supply the relevant *goods* under a **RTO agreement** for the first time;

(b) by the time it changes the *cash price* at which it offers to provide delivery or installation in relation to *goods* supplied under a **RTO agreement**; and

(c) no later than 12 *months* after the last time it established a **benchmarked price** under any provision of this *rule*.

5B.2.7 G (1) The *FCA* does not expect **RTO firms** to identify the *cash prices* for delivery and/or installation of identical goods. It will be sufficient for **RTO firms** to select *cash prices* for the delivery and/or installation of the category of *goods*. For example, **RTO firms** would need to find *cash prices* for the delivery and/or installation of washing machines but not for a particular model of washing machine.

(2) When selecting benchmarking *cash prices* for delivery, **RTO firms** should select prices which apply in comparable circumstances to those that apply to the **RTO firm**, for example in terms of distance or timing.

Entering into, varying or supplementing agreements: total cost of credit cap

5B.2.8 R (1) A **RTO firm** must not enter into a **RTO agreement** for *goods* (that are not second-hand) that provides for the payment by the *borrower* of one or more **charges** that, alone or in combination with any other **charge** under the **RTO agreement** or a **connected agreement**, exceed or are capable of exceeding the **benchmarked price** of the *goods* plus, where relevant:

(a) the **benchmarked price** for delivery;

(b) the **benchmarked price** for installation; and

(c) the *cash price* of *goods* or services supplied under a **connected agreement**.

(2) A **RTO firm** must not enter into a **RTO agreement** for second-hand *goods* that provides for the payment by the *borrower* of one or more **charges** that, alone or in combination with any other **charge** under the **RTO agreement** or a **connected agreement**, exceed or are capable of exceeding the *cash price* of the second-hand *goods* supplied plus, where relevant:

(a) the **benchmarked price** for delivery;

(b) the **benchmarked price** for installation; and

(c) the *cash price* of *goods* or services supplied by a **connected agreement**.

(3) A **RTO firm** must not enter into an arrangement to vary or supplement a **RTO agreement** by the supply of additional or different *goods*, where the arrangement provides for the payment by the *borrower*, in relation to the additional or different *goods*, of one or more **charges** that, alone or in combination with any other **charge** under the **RTO agreement** or a **connected agreement**, exceed or are capable of exceeding the **benchmarked price** of the additional or different *goods* (or in the case of second-hand additional or different *goods*, the *cash price* of the second-hand additional or different *goods*) supplied, plus, where relevant:

(a) the **benchmarked price** for delivery;

(b) the **benchmarked price** for installation; and

(c) the *cash price* of *goods* or services supplied by a **connected agreement**.

5B.2.9 G Where more than one item of *goods* and/or services is supplied under one **RTO agreement**, the total amount of the **charges** that may be payable by the *borrower* under that agreement should be calculated with reference to the sum of the **benchmarked price** of each of the *goods* and, where relevant, services. For example, where a **RTO agreement** covers the supply of a washing machine and dryer, and delivery and installation of both:

Washing machine: **benchmarked price** = £200

Dryer: **benchmarked price** = £250

Delivery: **benchmarked price** total = £30

Installation: **benchmarked price** total = £20

The sum of the **benchmarked prices** = £500

The total amount of **charges** that may, in addition, be payable by the *borrower* must not exceed £500.

5B.3 Anti-avoidance

5B.3.1 R **RTO firms** must not attempt to recover revenue that may be lost due to compliance with the total cost of credit cap *rules* through the price for other *goods* or services provided by the **RTO firm** in connection with a **RTO agreement**.

5B.3.2 G (1) For example, **RTO firms** should not seek to increase the price of theft or accidental damage insurance or extended warranties in order to recover revenue lost due to the cost cap *rules*.

(2) **RTO firms** are also reminded of the *rule* in *CONC* 7.7.5R, that *firms* must not impose charges on *customers* in default or arrears difficulties unless the charges are no higher than necessary to cover the reasonable costs to the *firm*.

5B.4 Policies and procedures for establishing benchmarked prices

5B.4.1 R A **RTO firm** must:

(1) establish, implement and maintain clear and effective policies and procedures to enable it to establish **benchmarked prices** under *CONC* 5B.2.2R, *CONC* 5B.2.4R and *CONC* 5B.2.6R;

(2) set out the policies and procedures in (1) in writing, and have them approved by its *governing body* or *senior personnel;*

(3) assess and periodically review:

(a) the effectiveness of the policies and procedures in (1); and

(b) the **RTO firm's** compliance with those policies and procedures and with its obligations under *CONC* 5B;

(4) in the light of (3), take appropriate measures to address any deficiencies in the policies and procedures or in the **RTO firm's** compliance with its obligations.

Obligations in competition law

5B.4.2 G **RTO firms** are reminded of their obligations to ensure compliance with competition law (including the prohibitions against anti-competitive agreements and abuse of a dominant position in Chapters 1 and 2 of the Competition Act 1998 and the criminal cartel offence in Section 188 of the Enterprise Act 2002 as amended by the Enterprise and Regulatory Reform Act 2013). Those obligations include:

(1) not entering into any agreements with other firms *w*here the agreement has as its object or effect an appreciable prevention, restriction or distortion of competition – for example to agree sale prices or to allocate customers. For example, if a **RTO firm** director called another **RTO firm** or a non-**RTO firm** and agreed to sell their products at a certain price, this would be restrictive of competition and illegal. The individuals involved could also be prosecuted for the criminal cartel offence; and

(2) not disclosing to, or accepting from, competitors any commercially sensitive information such as pricing or price planning, customer or market information or company strategy. For example, if a **RTO firm's** employee met or called another **RTO firm's** employee to find out any current or future pricing information whatsoever, that was not otherwise publicly available, whether for the purpose of attempting to fulfil any obligation under these *rules* or not, that could be illegal anti-competitive activity, even if the recipient of the information stayed silent.

5B.4.3 G **RTO firms** should also note the following points.

(1) The disclosure or receipt of commercially sensitive information may amount to a breach of competition law and could lead to infringement findings and fines not only in relation to the firm disclosing the information but also in relation to other firms receiving the information.

(2) A person commits the criminal cartel offence if they agree with one or more others to make or implement (or cause to be made or implemented) certain prohibited cartel arrangements relating to two or more businesses, namely price fixing, market sharing, bid-rigging, and limiting output. The maximum penalty on conviction for the criminal cartel offence is five years imprisonment and/or an unlimited fine.

(3) It is the responsibility of each firm to assess its own position under competition law (for example by taking its own legal advice) and to ensure all its staff are compliant with competition law and in particular that they know what is, and is not, lawful practice.

(4) Relevant guidance on competition law has been published by the Competition and Markets Authority.

[**Note:** for example, see:

Competition Law Risk a Short Guide at:

https://www.gov.uk/government/publications/competition-law-risk-a-short-guide

Limiting risk in relation to competitors' information at:

https://www.gov.uk/government/publications/limiting-risk-in-relation-to-competitors-information

Quick Guide to Complying with Competition Law at:

https://www.gov.uk/government/publications/how-small-businesses-can-comply-with-competition-law]

5B.5 Record keeping

5B.5.1 G **RTO firms** are reminded of their obligations in *SYSC* 9.1.1R to keep orderly records, which must be sufficient to enable the *FCA* to monitor the *firm's* compliance with the requirements of the *regulatory system*. Records which the *FCA* would consider to be sufficient to show compliance with the benchmarking requirements in *CONC* 5B include:

(1) point-in-time evidence of other benchmarking *cash prices* such as screengrabs or outputs of third party benchmarking data;

(2) evidence to show how the **RTO firm** took reasonable steps to ascertain whether the same item of *goods* or bundle of *goods* was available for sale by other retailers; and

(3) evidence to show how the **RTO firm** established that *goods* benchmarked against were comparable to those supplied by the **RTO firm**.

5B.6 Consequences of contravention of the total cost of credit cap

5B.6.1 R Where a **RTO firm** enters into a **RTO agreement** in contravention of a *rule* in *CONC* 5B.2.8R:

(1) an obligation in or under a **RTO agreement** that requires the *borrower* to pay **charges** which in total would exceed the total cost of credit cap, is unenforceable in its entirety; and

(2) the *borrower* is entitled to recover any amount paid in **charges**. If that is the case, at the written or oral request of the *borrower*, the **RTO firm** must, as soon as reasonably practicable following the request and in any case within 7 *days* of the request, repay to the *borrower* any **charges** paid by the *borrower* under or in connection with the **RTO agreement**.

5B.6.2 G Taking the example in *CONC* 5B.2.9G, if the agreement provided that the total amount of **charges** that may be payable by the *borrower* were £600 (so exceeding the sum of the **benchmarked prices** which was £500), the obligation to pay the £600 **charges** would be unenforceable, and where a *customer* had paid part or all of the £600, they would be entitled to have the amount of **charges** they had paid refunded by the **RTO firm**.

5B.7 Interpretation

5B.7.1 R In this chapter, words or terms used in *CONC* 5B which appear in bold (other than headings and titles) have the following meanings:

(1) "**associate**" means any *person* whose business or domestic relationship with a **RTO firm**, whether directly or indirectly, might reasonably be expected to give rise to a community of interest between them which may involve a conflict of interest in dealings with *consumers*;

(2) "**benchmarked price**" means a price calculated in accordance with *CONC* 5B.2.2R or *CONC* 5B.2.6R;

(3) "**charge**" is a charge payable, by way of interest or otherwise, in connection with the provision of *credit* under a **RTO agreement**, whether or not the agreement itself makes provision for this, and whether or not the *person* to whom it is payable is a party to the **RTO agreement** or an *authorised person*, and which would form part of *the total charge for credit*;

(4) "**connected agreement**" is an agreement:

(a) for delivery and/or installation of *goods* supplied under a **RTO agreement**; and/or

(b) which provides for a payment in connection with a **RTO agreement** where that payment would form part of the *total charge for credit*;

(5) "**household goods**" means *goods* which are normally found in a residential home and includes but is not limited to furniture, kitchen appliances (such as cookers, washing machines and dryers, microwaves, refrigerators and freezers), electronic and technological goods (such as vacuum cleaners, televisions and accessories, music systems and accessories, games consoles and accessories, computers, tablets and accessories and mobile phones);

(6) "**RTO agreement**" means a *regulated credit agreement* which is *a hire-purchase* or *conditional sale agreement* that supplies one or more items of **household goods**, but excluding those in relation to *goods* acquired principally for business purposes; and

(7) "**RTO firm**" means a *firm* whose business comprises or includes the

regulated activity of *entering into a regulated credit agreement as lender* and/or *exercising or having the right to exercise the lender's rights and duties under a regulated credit agreement*, in relation to one or more **RTO agreements,** as defined in *CONC* 5B.7.1R(5) and in relation to more than one category of **household goods**.

Appendix 2
Made rules (legal instrument)

HIGH COST CREDIT (RENT TO OWN WARRANTIES) INSTRUMENT 2018

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 (The FCA's general rules);
(2) section 137D (FCA general rules: product intervention);
(3) section 137T (General supplementary powers); and
(4) section 139A (Power of the FCA to give guidance).

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

Commencement

C. This instrument comes into force on 22 February 2019.

Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Product Intervention and Product Guidance sourcebook (PROD) is amended in accordance with Annex B to this instrument.

Citation

F. This instrument may be cited as the High Cost Credit (Rent to Own Warranties) Instrument 2018.

By order of the Board
15 November 2018

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

extended warranty	an agreement entered into by a *customer* for monetary consideration which provides cover, guarantees or undertakings in relation to defects in *goods*.
rent-to-own agreement	a *regulated credit agreement* which is a *hire-purchase agreement* or *conditional sale agreement* which provides for repayments to be made at intervals of less than one *month*, but excluding those in relation to *goods* acquired principally for business purposes or motor vehicles.

Annex B

Amendments to the Product Intervention and Product Governance sourcebook (PROD)

After PROD 1.4 (Application of PROD 4) insert the following new section, PROD 1.5. The text is not underlined.

1.5 Application of PROD 5

General: Who? What?

1.5.1 R *PROD* 5 applies to a *firm* which:

(1) offers to sell an *extended warranty* to a *customer*; or

(2) refers, invites or induces a *customer* to obtain an *extended warranty* from a *person* connected to the *firm*;

in connection with the entering into of a *rent-to-own agreement* with the *firm*.

1.5.2 G A *person* connected to the *firm* includes someone who has a relevant business relationship with the *firm*.

Where?

1.5.3 R *PROD* 5 applies to a *firm* with respect to activities carried on from an establishment maintained by it, or its *appointed representative*, in the *United Kingdom*.

EEA territorial scope rule: compatibility with European law

1.5.4 R (1) The territorial scope of *PROD* 5 is modified to the extent necessary to make it compatible with European law (see *PROD* 1.5.5G to *PROD* 1.5.7G for *guidance* on this).

(2) This *rule* overrides every other *rule* in *PROD* 5.

Effects of the EEA territorial scope rule

1.5.5 G The *guidance* in paragraph 2 of Part 4 of *ICOBS* 1 Annex 1 applies equally to the *rules* in *PROD* 5.

IDD, Solvency II, DMD: effect on territorial scope

1.5.6 G The *guidance* on the *IDD*, *Solvency II Directive* and *Distance Marketing Directive* in *ICOBS* 1 Annex 1 in relation to *ICOBS* 6A.1.4R applies equally to *PROD* 5.1.1R (to the extent that the *extended warranty* is a *contract of insurance*).

Electronic Commerce Directive: effect on territorial scope

1.5.7 G The *guidance* on the Electronic Commerce Directive in *ICOBS* 1 Annex 1, Part 4, paragraph 8 applies equally in relation to the *rules* in *PROD* 5.

…

After PROD 4 (Product governance: IDD) insert the following new chapter, PROD 5. The text is not underlined.

5 Extended warranties sold with rent-to-own agreements: customer information and deferred opt-in

5.1 Ensuring the customer can make an informed decision

5.1.1 R (1) A *firm* must give the *customer* the information in (3), at the same time and in the same *document*, when it offers to sell them an *extended warranty*.

(2) A *firm* must ensure that any other *person* to whom it has referred the *customer* or invited or induced the *customer* to obtain an extended warranty from gives the *customer* the information in (3), at the same time and in the same *document*, when that *person* offers to sell the *customer* an *extended warranty*.

(3) The information is:

(a) the total cost of the *extended warranty*, separate from any other prices, in the following terms:

(i) weekly;

(ii) annually; and

(iii) over the duration of the *rent-to-own agreement*;

(b) the significant features and benefits, significant and unusual exclusions or limitations of the *extended warranty*, with cross-references to the relevant warranty document provisions;

(c) a statement that *extended warranties* may be available from other *persons*;

(d) an explanation of how the *extended warranty* interacts with and compares against any other products sold or offered for sale in connection with the *rent-to-own agreement* (e.g. theft and accidental damage insurance);

(e) an explanation of how the *extended warranty* interacts with and compares against any standard manufacturer's warranty that may apply to the *goods* which are the subject of the *rent-to-own* agreement, given in a way that enables the *customer* to make a clear comparison between the two;

(f) when the *extended warranty* can be concluded, as described in *PROD* 5.2.1R; and

(g) the date the information in (a) to (f) is provided to the *customer*.

(4) The information in (3) must be communicated in a way that is:

(a) fair, clear and not misleading;

(b) in writing or another *durable medium*; and

(c) made available and accessible to the *customer*.

(5) The information in (3) must be drawn to the *customer's* attention and must be clearly identifiable as key information that the *customer* should read.

5.1.2 G (1) A *firm* that sells *extended warranties* that constitute *contracts of insurance* must also comply with the *rules* in *ICOBS* 6 (Product Information).

(2) *Firms* should also take into account the Supply of Extended Warranties on Domestic Electrical Goods Order 2005. Other consumer protection legislation may also be relevant.

5.2 Deferred opt-in for extended warranties

5.2.1 R (1) A *firm* must:

(a) not conclude the sale of an *extended warranty*; and

(b) ensure that no other *person* to whom the *firm* has referred the *customer* concludes the sale of an *extended warranty*;

until at least two clear *days* have passed since the required information was provided to the *customer* (*PROD* 5.1.1R).

(2) The period in (1) is one clear *day* after providing the information if the *customer*:

(a) initiates the conclusion of the sale of the *extended warranty*;

(b) consents to the conclusion of the sale of the *extended warranty* earlier than provided for in (1); and

(c) confirms that they understand the restriction in (1).

5.2.2 G For example, if a *firm* provided the required information to the *customer* on Monday, it would not (absent the *customer's* consent) be able to conclude the sale of the *extended warranty* until Thursday.

5.2.3 G Before the conclusion of the sale of an *extended warranty*, a *firm* should have regard to the information needs of its *customers* and consider whether it would be in the *customer's* interest to receive the information in *PROD* 5.1.1R again, for example if a long time has passed between the provision of the information and the conclusion of the sale.

Pub ref: 005825

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