The Money Charity response to the credit card market review interim report

The Money Charity is the UK's leading financial capability charity.

We believe that being on top of your money means you are more in control of your life, your finances and your debts, reducing stress and hardship. And that being on top of your money increases your wellbeing, helps you achieve your goals and live a happier more positive life as a result.

Our vision is for everyone to be on top of their money as a part of everyday life. So, we empower people across the UK to build the skills, knowledge, attitudes and behaviours, to make the most of their money throughout their lives.

We believe financially capable people are on top of and make the most of their money in five key areas:

- Planning (including budgeting)
- Saving
- Debt
- Financial services products
- Everyday money (including wages, cash, bank accounts)

1. As the UK's financial capability charity The Money Charity welcomes the Credit Card Market Study (CCMS). When the average household holds £2,336 in credit card debt[1], it is a huge issue and a central part of millions of people's financial management. Understanding consumer behaviour and recognising whether and where detriment occurs is therefore a vital task for the regulator.

2. Though we would like to see in the final report further analysis of areas the interim report has not touched on (see points 15-18 below), the statistical analysis was helpful, furthered our understanding of the market and provided a strong evidential underpinning for any regulation.

3. Used appropriately, revolving credit products like credit cards provide valuable flexibility of amounts owed and amounts repaid each month, allowing consumers to borrow more or less in a given month depending on their needs. However, this lack of structure around borrowing and repayments also makes it relatively easy to build up large amounts of debt that remain outstanding for a long period, and both StepChange[2] and Citizens Advice[3] report credit card debt as one of the most common – and largest – debt issues seen by their advisers. We were therefore particularly interested in the data collected on unaffordable credit.

4. For us, the research painted a worrying picture. That 18.7% (5.8 million) of consumers displayed at least one indicator of problem debt on a scale from systematic minimum repayments to severe arrears shows that a significant portion – 11.5% of all UK adults - of consumers are suffering material detriment as a result of the credit cards they use.

5. The extent of unaffordable credit card debt warrants more concern than has been evident in the CCMS. There are two different types of consumer detriment that we would like to see the FCA address in its regulation:

    a. People struggling under a debt burden that is immediately problematic – crisis debt
    b. People paying more and / or taking longer than they need to in repaying debt.

6. For the first group, the FCA clearly understands that debt is problematic and is suggesting welcome remedies such as earlier forbearance and discussing cost caps.

7. By contrast, the response to the second group is far more sanguine. Those with persistent debt and who exhibit systematic minimum repayment are treated as if their problematic debt is not a huge issue. Even though *'these groups are paying more in debt service cost and taking longer to pay off debt than they need to',* there only appears to be some concern about the possibility that debt *'becomes problematic in the future'*.

8. While we understand that an immediate crisis where a consumer cannot repay and goes into arears is more damaging and more urgent than long-term overpaying, both are problematic. If, either because they cannot afford to make more than minimum payments or because they misunderstand the product, consumers are paying too much for credit, it is something that should be considered problematic and addressed through regulatory action more prescriptive than the *'nudges'* like encouraging

[1] http://themoneycharity.org.uk/money-statistics/
[2] http://www.stepchange.org/Portals/0/documents/media/PersonalStatsYearbook2013.pdf
[3] http://www.citizensadvice.org.uk//national_issues_q2_2014-15_-_at_appendix.xls

disclosures and opt-in pre-set repayment options discussed in the CCMS' final chapter.

9. The current features of credit cards allow people who cannot afford to repay their debt to mask crisis. The low level of repayment required to retain a debt facility on a month-to-month basis means that a consumer has to be in a very serious squeeze on income to be unable to make a minimum payment. Given the psychology of consumers who tend to privilege short-term benefits over the long-term, it is inevitable that behaviour will tend towards the '*over-borrowing and under-repayment*' shown in the CCMS. Consumers should not be left in a situation where they systematically overpay and are vulnerable to changes in personal circumstances and / or changes to the credit card market or interest rates. With the UK Cards association claiming that 56% of borrowers making the minimum payment at least once during a year did so because they could not afford to pay more[4], it is clear that for many consumers, crisis is not that far away.

10. Ultimately, the regulatory treatment of credit cards should have some consideration of the purpose of the product. The central benefit to the consumer of credit cards is that they allow the cost of large purchases to be spread over a period of time and variable income to be smoothed. Regulation should reflect this, and discourage credit cards being used as a borrowing facility paid for by a minimum or low payment – which is clearly the case for many consumers with 8.9% of balances set to take more than 10 years to pay off at current repayment levels.

11. For us these cost spreading and income smoothing functions are the positive innovations of the credit card market – and provide consumers with a much greater ability to take control over their finances. However, we recognise that this is debatable and would want to see the FCA include an exploration of the social purpose of the credit card market in the final report and define clearly what it thinks the market ought to achieve. This analysis should also (along with the excellent evidence already being collected) form the basis for any future regulatory response.

12. When we compare the treatment of the credit card market to high cost short term credit (HCSTC), it is difficult not to see inconsistency. The maximum interest rates and cap on total repayment imposed on that much smaller market is difficult to square with the relative inaction over credit cards – particularly when more than 2 million consumers are in serious or severe arrears. Perhaps because credit cards are used across society and across income levels including the middle classes they are treated with a more laissez faire attitude than HCSTC, even where consumer detriment is comparable.

13. Much of the opprobrium surrounding HCSTC stemmed from evidence that a product ostensibly providing short-term income smoothing was being routinely rolled over by many consumers who simply didn't have the income to repay. In this case it was recognised that a rolling payday loan not only resulted in overpayment but also was *not fulfilling the purpose of the product*. Why, if regulation can be used to ensure the payday market is confined to its purpose, can this not be achieved in the credit card market?

14. We recognise that consumers value the flexibility of credit cards, so we would not recommend that minimum repayments for *every* month are increased to 5% or 10%,

[4] http://www.theukcardsassociation.org.uk/wm_documents/credit_and_store_cards_review_-_the_uk_cards_association.pdf

but we would want to see options explored that prevent systematic minimum repayment and persistent debt such as:

a. Limiting the number of minimum payments that can be made in any 12 month period.
b. Tapering minimum repayments up over time.
c. Creating a minimum average level of repayment over a year.
d. Converting long-term unpaid balances to loans with fixed repayment terms and withdrawing the credit card after 2 years.

15. Given the relatively few consumers who are paying more than double what they originally borrowed, we do not see any argument for not imposing the same total repayment cap that applies to HCSTC in order to protect a small number of the most vulnerable consumers.

16. Were it the case that '*non-problem debt'* is unprofitable (or that incoming interchange fee regulation was going to make it unprofitable), there would be an argument that more prescriptive regulation to encourage faster repayment would damage the credit card market as a whole - with all the individual and macroeconomic problems that this would incur. However, the profitability with these consumers is consistent with those showing systematic minimum repayment and persistent debt, and considerably better than it is for any consumers in arrears. So it cannot be argued that regulation that prevents overpaying will damage the market.

Additional areas to explore

17. Many consumers, particularly those with problematic debt, will have more than one credit card. We would want to see analysis that looks at individual consumers and the bundle of cards they have, rather than treating the card itself as the unit of analysis.

18. According to StepChange, nearly all clients who come to them with problem HCSTC also have credit card debt - the final CCMS should explore how credit cards interact with other forms of credit, particularly unsecured credit.

19. The definition of persistent debt uses the measure of 90% of credit limit utilisation. In order to understand potential detriment to consumers, we would like to see the absolute level of debt and the ratio of debt to income analysed.

20. Impact analysis of the regulations outlined in paragraphs 12 and 13 as well as those discussed in the final chapter of the CCMS.

Conclusion

21. With the research carried out for the CCMS, the FCA has the opportunity to ground the regulation of the credit card market not simply on logical augment or what rational behaviour would be, but a granular understanding of how consumers actually behave. The findings in the interim report provide a firm basis for regulatory action, but only if consumer detriment is recognised where it exists. If we compare the relatively sanguine attitude to, say, 1.6 million cardholders making systematic minimum repayments in the CCMS to the response to the payday market it is difficult to escape the conclusion that credit cards are treated differently because they are seen as a middle class product so should not be regulated to the same degree.

22. In order to give consumers the protection they need to take stay on top of their finances, the FCA must understand that consumer detriment does not only happen when a short-term crisis occurs, but must also when people are significantly overpaying or unable to repay their debts over the long-term, even when monthly payments appear manageable.

23. As happened with HCSTC loans, product innovation has allowed people to use credit cards in a way that goes beyond their social purpose and, in many cases, causes harm. This innovation and the marketing that accompanies it has fed through to a consumer psychology that sees cards as providing an “amount of ‘new money’ available to spend”, rather than debt that could be taken on but that will have to be repaid[5].

24. The Money Charity believes that widely available consumer credit is something that *can* do great things for individuals and society – spreading costs and smoothing income. The CCMS provides a once in a generation opportunity to improve the credit card market by redefining and re-founding its social purpose. But for all the excellent research we read in the interim report, we fear that the FCA is not approaching their task with sufficient vision to achieve this end.

[5] https://www.fca.org.uk/static/fca/documents/research/jigsaw-research-consumercredit-overdrafts-creditcards.pdf