



The Money Charity response to FCA CP18/42 on Overdrafts (Mar 2019)

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)

The **MONEY** *Charity*

The Money Charity welcomes the opportunity to comment on the FCA's Consultation Paper CP18/42 on Overdrafts.

As explained on the cover page, we are a financial capability charity whose vision is to empower people across the UK to build the skills, knowledge, attitudes and behaviours, to make the most of their money throughout their lives.

Complementing our financial capability work we engage with financial services policy, as the design, pricing and presentation of financial products have a direct bearing on people's ability to behave in financially capable ways.

Our response to this consultation derives from:

1. Our mission as providers of consumer financial capability.
2. Our sense of what is "fair" in terms of the design and pricing of financial services.

On the second point, we recently responded to the FCA's consultation on "**Fair pricing in financial services**" (DP18/9). In this response we pointed out that there is a large philosophical, psychological and economic literature on fairness, comparable to (or even greater than) that on behavioural economics. Just as the FCA has become an expert on behavioural economics, we argue that it should take a similar approach to fairness, building on its existing approach of remedying consumer harm.

This Consultation Paper on overdrafts (CP18/42) is an example of the application of the principles of fairness to a particular case of financial service pricing.

In our review of the literature, we found that one of the key principles is reciprocity – the idea that both sides to a transaction should gain in balanced ways, without either side being "ripped off": a good price for quality of service in exchange for a reasonable profit.

In our view, the FCA has correctly concluded that many overdraft prices, especially for unarranged overdrafts, breach this principle, and that changes to the rules are needed. We support the changes proposed by the FCA, subject to the additional points made in answer to the questions below.

Q1: Do you agree with our proposal to align the charges for arranged and unarranged overdrafts?

Yes, we agree with CP18/42 that this will both simplify and reduce overdraft charges, improving both transparency and fairness.

Q2: Do you agree with our analysis that our rules on alignment should not allow firms to charge more for unarranged overdraft use (no uplift)? If you disagree with our analysis, please provide evidence outlining the additional costs an uplift is required to cover and the level of uplift required.

Yes, we agree with the proposed “no uplift” rule. We note that firms have found it hard to provide FCA with evidence that there is any significant difference in costs between arranged and unarranged overdrafts.¹ It appears that higher charges for unarranged overdrafts reflect market power rather than costs.

Q3: Do you agree with our proposal that charges for unarranged overdrafts should be unenforceable if their level exceeds the level of arranged charges?

The wording of this proposal (paragraph 4.13) strikes us as strange, in that a firm does not have to ‘enforce’ a charge. It simply deducts the charge from the customer’s account, leaving the customer in the position of having to enforce the refund. In our view, it would be better if it were made clear that any charge in excess of the cost of an arranged overdraft is against the rules and, if made, should be refunded by the firm. The onus should be on the firm. A breach of the rules should lead to regulatory action, including fines for non-compliance.

Naturally, the customer should be able to reclaim an excessive charge, but the refund should not be dependent on customer action.

Q4: Do you agree that firms should be required to charge for overdrafts by a single interest rate?

Yes, we agree with this. It is the fixed fees that cause excessive interest rates on lending, so moving to a single interest rate regime will greatly reduce the harm experienced by some borrowers.

Q5: Do you agree that we should require firms to disclose the representative APR in advertising where the representative example or representative APR is triggered?

¹ CP18/42, page 27.

We agree with the proposal set out in paragraphs 4.30 to 4.36 of the Consultation Paper. However, we are sceptical that APR will be used by many consumers as a means of comparing overdraft prices and deciding who to bank with. This strikes us as a case of imagining a desired “ideal” consumer, rather than actual consumers in the real world. In our experience it is the £ and pence cost of an overdraft that is meaningful to consumers and relevant to the decision whether or not to take action, rather than APR, which has a theoretical quality for many and may be overlooked entirely.

In this respect, we note from the FCA’s consumer research that *even the best performing presentations of overdraft interest rates still involve over 30% of respondents either not knowing which deal is best or picking the wrong deal.*² This is a sobering statistic, but one that tells us a lot about the world in which many consumers live.

We suggest that the FCA should focus on the prominence and clarity with which banks communicate the real cost of overdrafts in £ and pence.

Q6: Do you agree with our proposed guidance to help firms to calculate APR consistently?

We agree with the proposals set out in paragraphs 4.39 (for taking account of interest rate free periods) and 4.40 (for taking account of fees) of the Consultation Paper. The APR should be a fair and consistent reflection of the cost of credit, taking account of any variations in the terms of the deal.

We disagree with the use of £1,200 as the representative amount, for the reasons set out in answer to Question 9 below. We think it would be better to use a significantly lower amount, in the middle of the range of typical overdraft borrowing.

Q7: Do you agree that in addition to existing rules in CONC regarding the disclosure and prominence of the representative example and representative APR, we should require firms to include the title ‘how does our overdraft compare’ and explain that representative APR can help consumers compare the overdraft?

Yes, we agree with the proposal set out in paragraph 4.45 of the Consultation Paper. In our financial capability work, we encourage consumers to compare deals for goods, services and credit, and APR is one of the terms we cover.

² CP18/42 Annexes, Chapter 7, page 15.

At the same time, as noted in our answer to Question 5, we think the main focus should be on the £ and pence conversion to enable consumers to fully understand the cost of an overdraft.

Q8: Do you agree that firms should report to the FCA information about their representative APR and that we should publish this information?

Yes, we agree with this proposal, as set out in paragraph 4.46 of the Consultation Paper. In addition, we think it important that the FCA requires firms to supply validating information for the rates reported, ie the number and proportion of customers to whom the reported rates applied. The wording around this ('the rate firms reasonably expect a majority of consumers responding to the advert to be offered')³ is elastic and we think it essential that the FCA makes sure firms do not over-stretch the facts in deciding what rates to report.

Q9: Do you agree that it would be helpful for firms to give consumers a clear example showing what an overdraft might cost in pounds and pence if they borrowed money for a period of a day, a week, a month or a year?

We think this is essential. The one benefit of the current regime of fixed charges for overdrafts is that they are clear to the consumer, especially when the consumer receives prompts along the lines of: "your account is now overdrawn. You will be charged £xyz at the end of the day if you do not deposit funds before then." This type of communication is clear and, insofar as consumers have the funds to take action, it is action-prompting.

On the grounds of fairness, we agree with the FCA's proposal to abolish such charges and move to a single interest rate, however we think this needs to be supplemented by £ and pence communications, along lines such as: "based on your current overdraft, you will be charged £x and y pence per day until you deposit funds to clear the overdraft."

If a consumer continues to spend in the course of the day they fall into overdraft, the end-of-day cost of the overdraft will change, and this will need to be reflected in up-to-date prompts. A sensible balance must be struck between making sure the prompts are accurate and overdoing it by bombarding the consumer with updated overdraft warnings. For example, there could be a prompt when the account first goes into

³ Paragraph 4.32, CP18/42, page 33.

overdraft, followed by a mid-afternoon update, giving the consumer time to take action before the end of the working day.

Pounds and pence examples

We agree with the format proposed in paragraph 4.49 of the Consultation Paper, ie boxes showing the £ and pence cost per day, week, month and year. This is clear and accessible to consumers who do not understand percentages, or how to convert an interest rate into £ and pence.

However, we note that in the cards presented to consumers in the consumer testing research,⁴ there is a clash between an APR expressed in relation to an “assumed overdraft of £1200” and the £ and pence examples based on a notional £500 overdraft. The £1200 is in bold type, while the £500 is in smaller plain type. On first glance, the reader is inclined to read the £ and pence examples as relating to the £1200 overdraft, not to the £500 example.

This potential source of confusion needs to be cleared up, either by dropping the reference to £1200 altogether⁵ or reducing the £1200 to a footnote, while making the £500 larger and bold.

The consultation paper⁶ reports that “the majority of arranged borrowing is for under £250” and “the majority of unarranged borrowing is for under £50”. This being the case, we suggest that the FCA lowers the amount used for the example even further, placing it in the middle of the range of typical overdraft borrowing.

This would make the £ and pence examples more representative of the overdraft cost most people are likely to face and therefore easier to understand, promoting financial capability.

Clear and accessible communications

As firms will have discretion over how to present these APRs and £ and pence examples, we think it important that the FCA reminds firms of the requirements for clear communications with an accessible reading age.⁷ The key variables in reading age are sentence length and frequency of words with three or more syllables, so the key requirements for accessible communications are short sentences and short words. According to the National Literacy Trust one sixth of UK adults (nine million people)

⁴ Card 6, CP 18/42 Annexes, Chapter 7, page 14

⁵ Our understanding is that the £1200 comes from CONC 3.5.13 and ultimately from the EU Consumer Credit Directive, so we invite the FCA to consider how best to remove or de-emphasise the reference to £1200.

⁶ CP18/42, page 9.

⁷ We have also commented on reading ages in our response to the Buy Now Pay Later consultation.

have a reading age of 11 or less, so for communications to be pitched at a genuinely accessible level, they must have a relatively low reading age.

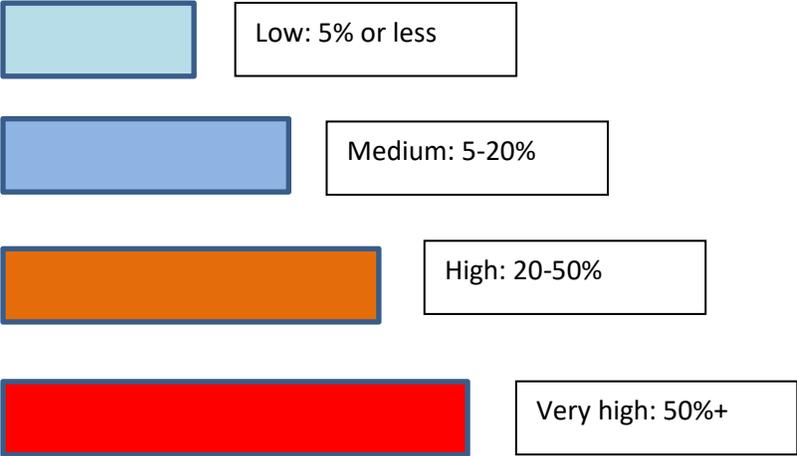
Further, while we applaud the FCA for testing a number of approaches to consumer communications, the tested methods tend to be monochrome, relying on black and white, with words and numbers on paper. In many settings outside financial services, firms and agencies have moved to colour scales for ease of consumer recognition. For example: home energy ratings, sugar content of foods, appliance environmental ratings. We think the FCA should consider developing a colour scale for the cost of credit. An example is shown in Figure 1 below.

We see advantages and some potential disadvantages in such a scale, which should be tested by market research.

Disadvantages could be that certain consumers find that all their credit options are “red” or that they are characterised as “red consumers” by the industry, which would give rise to the usual problems of labelling and stereotyping.

On the other hand, a colour scale is much easier to understand than written text or numbers. It has a lighter cognitive load, which is why colour codes are used in other industry and regulatory contexts.⁸ We think that an appropriate colour scale could have a role to play in consumer finance communications, though we think it should be tested before adoption, in case the disadvantages turn out to be larger than we would like. We suggest it be added to the FCA’s consumer testing programme.

Figure 1: Potential colour scale for interest rates



⁸ For a financial services example, see <https://www.elifinty.com/>, where “information” is coded blue and “act” is coded red.

Note on colour selection: Colours need to be distinguishable for people with the various types of colour blindness. Green is avoided for this reason and also for its traffic light association of “green = safe to go” which is not always the case with credit.

Q10: Do you agree with our proposals for guidance for recovering costs via refused payment fees? If you disagree, please set out which costs should be excluded and why, and which costs should be included and why.

Yes, we agree with the proposals set out in paragraphs 4.64 to 4.68 of the Consultation Paper, which we interpret as being to charge the marginal costs of refused payments rather than firms’ wider fixed costs. We note that the phrase “certain infrastructure costs, as long as these can be reasonably allocated to the activity of refusing payments according to an appropriate accounting methodology”⁹ is elastic and will need careful supervision by the FCA to ensure it is not used as a backdoor for loading wider fixed costs onto refused payments charges.

Q11: Do you agree with our proposed application of the rules?

Yes, we agree with the proposed application set out on pages 40-41 of the Consultation Paper.

Q12: Do you agree that firms should be given 6 months to comply with the proposed rules?

Yes, this seems like a fair period of time to implement the changes.

Q13: Do you have comments, observations or evidence on whether overdrafts provided to micro-business customers or products marketed to consumers as having the same function as an overdraft should be subject to similar rules to those proposed in this CP?

We do not see the rationale for excluding micro-business customers or products with the same function as overdrafts. In our view these should be covered, especially as this is an area of financial innovation.¹⁰ To achieve the FCA’s objectives of making all such products comparable and helping consumers think of overdrafts as a type of debt

⁹ CP18/42, paragraph 4.65.

¹⁰ See for example, <https://www.accounttechnologies.com/>

comparable to other debt available on the market, we think all types of overdraft should be covered.

From feedback we receive, SME business accounts lack many of the features now being offered to personal customers and are badly in need of innovation. Media reports of shortcomings in business bank accounts have highlighted unfair overdraft deals.¹¹ For these reasons, we think the FCA should require SME business accounts to comply with the same overdraft rules as personal accounts and to offer the same range of tools, such as account alerts.

Q14: Do you agree with our final proposals for addressing the harm from repeat use of overdrafts?

Yes, we agree with the proposals set out in paragraphs 5.10 and 5.11 on addressing harm from repeat overdraft use, including the separation of those who use overdrafts consciously and affordably from those for whom such use reflects financial distress.

We have two additional suggestions:

(1) At present some consumers find they have to change banks in order to “park” an overdraft and manage it as debt. When income arrives in their account, the overdraft is automatically reduced, making the overdraft in effect the top priority debt, even if there are other more dangerous debts the consumer needs to deal with.¹² By switching banks, consumers put themselves back in control of their income.

It would be desirable for both parties for banks to develop processes whereby customers in financial difficulties can reduce their overdraft in stages, giving priority to other debts and expenses - without having to switch current account provider to regain control.

(2) Where repeat overdraft use reflects financial difficulties, banks’ vulnerability policies should kick in. Banks should not stop at a warning to suspend overdraft use, but should look behind the problem to see if other solutions are required, including, if necessary, referral to a debt advice agency.

If banks implement a personalised approach to all their customers, this should happen as a matter of course, but given the industry’s journey, we think it would be worth making this point explicit.

¹¹ For example, <https://www.telegraph.co.uk/business/best-bank-for-small-business/the-right-current-account-for-you/>

¹² We realise that this is to some extent an illusion, in that the customer could increase their overdraft again to pay other debts or expenses. However, in terms of consumer psychology, it can be a damaging illusion.

Q15: Do you agree with the changes proposed in chapter 8?

Yes, we agree with the timing and other proposals set out in Chapter 8 of CP 18/42 (page 78). As a financial capability charity, we particularly support the reforms to communication such as alerts, eligibility tools and overdraft calculators. As we have said earlier in this response, the consumer needs to know exactly what services will cost in terms of £ and pence and when payments need to be made. Anything that can facilitate this is to be welcomed.

Q16: Do you agree with our cost-benefit analysis?

We are not in a position to review the business side of the CB analysis, however we note the FCA's conclusion that any additional costs will be justified by the reduction in consumer harm the revised rules will bring about. We note from the FCA's analysis that:

- Most unarranged overdraft fees are paid by a very small proportion of current account customers.
- Many of these customers are people living in areas of higher deprivation. This is an example of the “poverty premium” identified by other agencies.¹³
- Because of the fixed charging structure, *daily* interest rates on unarranged overdrafts regularly exceed 10%, and for a significant number of consumers exceed 20% *per day*.¹⁴

We agree with the FCA's judgement that there is a paradox in the current regime of overdraft pricing, which is that “the pricing structure heavily penalises short-term use, which is precisely what the product is intended for.”¹⁵

We note from Figures 4.3 and 4.4 on page 37 of the Consultation Paper that the intention of the reforms is to “haircut” the overdraft market in such a way that all the cases of particularly high daily rates will be removed, while the bulk of overdraft lending on reasonable terms will continue unaffected. The reforms will also remove all the cases of overdraft lending involving excessive ratios of annual fees to peak borrowing.

We welcome these changes.

(end)

¹³ See for example: <http://www.smf.co.uk/wp-content/uploads/2018/03/Measuring-the-Poverty-Premium.pdf>

¹⁴ CP18/42, Annex 2, page 83.

¹⁵ Ibid.