Response to the FCA's proposals for a price cap on high-cost short-term credit

Introduction

1. As the UK's financial capability charity, we welcome the opportunity to respond to this consultation.

2. 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.

3. 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.

4. We believe that financially capable people are on top of and make the most of their money in these 5 key areas:
    - Planning (including budgeting)
    - Saving
    - Debt
    - Financial services products
    - Everyday money (including wages, cash, bank accounts)

5. A cap on the cost of high-cost short-term credit (HCSTC) will affect consumers' engagement with and access to financial services products, as well as affecting the debt they can build up in relation to a single payday loan. Our response, therefore, is focused on how the proposals will impact consumers from a financial capability perspective.

6. We have been impressed with the approach taken by the FCA to developing this cap, both in terms of its engagement with consumer groups and industry, and the research it has undertaken to support its proposals. Overall, we believe the proposals will provide an appropriate degree of consumer protection while not unduly damaging the market.

7. However, this conclusion is dependent on the FCA's research and analysis being thorough and correctly interpreted. We are not in a position to replicate the FCA's work, but we are concerned that the research into consumer detriment has missed the potential wider impact of losing access to credit, and therefore is incomplete.

8. We also believe that a cap on default fees and charges that is the same amount for a loan of any size could have unintended consequences that deter borrowers with smaller loans who default from trying to repay quickly after defaulting. Finally, we are unclear about the rationale for excluding other forms of HCSTC from this cap, and feel that this should be revisited.

Q1: Do you have any comments on our general approach to developing our proposals for the price cap?

9. We are impressed with the amount and quality of research the FCA has undertaken while developing its proposals for the price cap, both with regard to industry and to consumers.

10. We recognise that implementing a price cap is a new area for the FCA, and therefore the exact impact on consumers and the market is inherently uncertain, even with the careful supporting analysis. We welcome the FCA's commitment to review the cap in two years, although we assume that it will be kept under review during that period should there be any dramatic unintended consequences, given the scope for serious consumer detriment if there were to be an unexpected outcome of the proposals.

Q2: Do you have any comments on the proposed price cap structure?

11. We broadly feel that the structure of the price cap, with a limit on daily fees and charges, a limit on default fees, and an overall total limit, makes sense.

12. However, we are concerned that one unintended consequence of setting the maximum default charge at £15, regardless of the size of the loan, could be to disadvantage borrowers who default on smaller loans but then manage to recover and repay a few days late.

13. We expect most lenders to impose the full £15 maximum fee at the first point of default, as any other default fee structure would increase administration costs by increasing the number of charges collected. It would also make it less likely that the

amount collected in default fees would cover those administration costs, as some borrowers who defaulted might then recover and repay without incurring further charges.

14. Under the current proposals, borrowers who repay on time are protected by the daily interest rate and charges cap of 0.8%, while borrowers who run into severe difficulties are protected by the overall 100% cap on the cost of credit. But for borrowers who can't repay on time and go into default, then recover and are able to repay all outstanding charges a short time later, the default fee will be a high proportion of the charges and fees that they pay.

15. Take the example of a borrower who takes out a 30-day loan of £100 but doesn't repay anything until the 35th day when they settle the debt in full. If the lender charged the maximum permitted under the cap with no arrangement fees, that borrower would repay a total of £143. Of the £43 interest and charges, the default fee would make up more than a third. A borrower who takes out a £500 loan and repays in the same scenario would repay £155 in interest of which the default fee would make up less than a tenth. If that borrower failed to repay until the 100% cost of credit cap had been reached, the default fee would make up just 3% of the fees and charges repaid.

16. This means that for someone who borrows a smaller amount but then defaults, the incentive to try to recover and repay quickly is reduced, because a high proportion of the interest and charges they would repay in that scenario has already been incurred.

17. We recognise that a fixed maximum amount in default charges reflects the fact that the administrative costs of a customer defaulting are unlikely to change depending on the size of the loan, and that to allow this to vary could allow firms to profit from customers defaulting. But we also believe that regulation should encourage consumers to do the best they can to repay in any given circumstance. Under the proposals the default cap will have the biggest proportional impact on borrowers of smaller amounts who then try to recover, which feels inherently counter-intuitive.

Q3: Do you have any comments on the price cap levels?

18. The daily cap on interest has, as paragraph 5.18 of the consultation notes, been set at the lowest point at which the continued existence of the market is not threatened. If the underlying analysis is correct we feel this is appropriate, but we would highlight that if the FCA's assumptions about firms' continued participation in the market are wrong, there is little room for manoeuvre: if the cap has been set at slightly too low a level, the FCA's own analysis suggests that it risks damaging the viability of the entire market.

19. We do not have any particular comments on the cap on default fees, other than our concerns highlighted in response to Q2. We particularly welcome the simple cap of 100% on the total amount repaid, as this is easy for consumers to understand and

calculate, which is important with regard to their financial capability and ability to understand how the cap could affect them.

Q4: Do you agree with our proposals on repeat borrowing?

20. We agree with the proposals to encourage greater use of real-time data and closely monitor firms' repeat lending decisions. It is particularly important that the FCA closely monitors repeat lending decisions, as if firms are able to circumvent the cap then the consumer detriment that the FCA has identified will simply be allowed to continue through a different mechanism.

Q5: Do you have any comments on the scope of the price cap?

21. The scope of the price cap has been drawn very tightly, which combined with the low level of the cap lacks some coherence.

22. As paragraph 5.18 states, the cap has been set at what the FCA's analysis found to be the lowest point possible without regulating the HCSTC market out of existence. This suggests that the FCA believes there is a significant consumer protection issue in this market at present – while the duty to impose a cap was placed on the FCA, it was open to the FCA to set this cap at a level that would have had little impact on the market.

23. However, by limiting the scope of the cap to the Handbook's definition of HCSTC, and explicitly excluding other forms of high-cost credit from that definition, the applicability of the cap has been drawn very narrowly. It only impacts part of the high-cost credit market, but it impacts that part greatly, while ignoring other high-cost credit options such as home-collected credit and rent-to-own.

24. If the FCA believes the potential for consumer detriment in the HCSTC market is high enough to warrant such a restrictive cap, it should extend this cap to similar markets. Not doing so is intellectually confused, and also potentially raises competition issues if a payday lender is subject to the cap but home-collected credit, which could offer a product on a very similar model, is not.

25. Other stakeholders have repeatedly raised issues around overdrafts and credit cards. We do not believe this cap should apply to these products, but we welcome the FCA's focus on these markets and look forward to a similarly rigorous analysis on these in due course.

Q6: Do you have any comments on our proposed Handbook rules?

26. No.

Q7: Do you agree with our proposals on unenforceability?

27. We agree that agreements that breach the cap should be rendered entirely unenforceable. The level of the overall cap at 100% is particularly welcome in this regard, as it will help consumers to identify when an agreement is in breach of the cap and therefore unenforceable.

Q8: Do you agree that we should prevent UK-based debt administrators from enforcing HCSTC agreements on behalf of ECD lenders which include charges in excess of the price cap?

28. Yes.

Q9: Do you have any comments on the proposed approach to data sharing?

29. We welcome the FCA's encouragement of greater use of real-time data-sharing by lenders.

Q10: Do you agree with the costs and benefits identified?

30. We are pleased that the FCA has considered both the potential impact on consumer wellbeing and the functioning of the market when developing its proposals for the cap.

31. However, we believe more could be done to understand the potential impact on customers excluded from HCSTC who do not borrow from another source. The FCA's consumer research rightly goes into considerable detail about the experience of consumers who borrowed from other sources after being turned down for HCSTC, but if a customer answered 'Made a decision to go without the money' or 'Nothing – had nowhere else to borrow the money from' little further is asked about the impact that actually had.

32. Given that 55% of those in the FCA's sample borrowed to meet 'essential everyday expenditure' (par 3.13), how people would have coped without access to funds for this everyday expenditure would be a helpful area to explore further to fully understand the impact of losing access to what is, for many, the only form of credit available.

33. This is a particularly important issue because the FCA's entire approach has been to weigh up the consumer benefit, consumer detriment, and the impact on firms, and the wellbeing research is hugely important to the impact on consumers. Therefore, the fact that the FCA has not considered what actions individuals without access to

alternative funds took or would take without access to HCSTC leaves a blind spot in its research.

34. We expect that some of the impacts of not being able to borrow will have been observed in the questions on financial wellbeing, and we also recognise that customers who wish to take out HCSTC to pay for essential everyday spending may be better served by other options than accessing credit, so it is possible that this omission would not significantly affect the FCA's overall conclusion as to the costs and benefits of its proposals. But we nevertheless regard this as a significant flaw in the FCA's analysis.

Q11: Do you agree with our assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?

35. We have no comment to make on this.