The MONEY Charity

Response to the FCA's credit card market study terms of reference

1. As the UK's financial capability charity, we welcome the FCA's focus on the credit card market.

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 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)

5. The credit card market is a significant part of the consumer credit sector – in October 2014 amounts outstanding on credit cards accounted for 35% of overall outstanding consumer lending[1]. It is therefore important that these products, and the firms behind them, operate in a way that helps consumers to manage their use of credit.

6. 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

[1] Analysis of Bank of England data from December 2014 edition of Bankstats
[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

– and largest – debt issues seen by their advisers. We are therefore particularly pleased by the FCA's focus on unaffordable credit card debt as part of this study, but we also welcome the terms of reference as a whole.

7. We believe that regulation should take into account how consumers behave in practice, not simply how a perfectly rational and informed individual would. In developing our response here, we have drawn on the FCA-commissioned qualitative consumer research into credit cards published earlier this year, which we refer to as the Jigsaw research[4], which provides illuminating insight into consumers' experiences of credit card use.

8. There are a number of issues within the credit card market that we believe impact negatively upon people's ability to stay on top of their money, and would urge the FCA to explore these as part of its study. These fall into two categories:

    - Unsolicited credit limit increases and limits that are higher than requested.
    - Minimum repayments and creditor behaviour around customers who repeatedly make low repayments.

Credit limits

9. When applying for a credit card, consumers are often asked to state the credit limit they desire. However, the credit limit then offered may bear little relation to the amount requested.

10. Where the amount offered is lower, this may be for valid lending reasons. However we are also aware of consumers being offered *more* than they requested at the point of application. It is difficult to see any justification for this other than encouraging additional, unnecessary borrowing – which is not in the consumer's interests.

11. A related issue is that of unsolicited credit limit increases. Best practice guidelines[5] produced by the UK Cards Association and incorporated into the Lending Code purports to give customers control of their credit limit (section 2.3 of the guidelines) by allowing them to reject an unsolicited increase, request that no unsolicited increases at all are made, or to request a reduction in their credit limit.

12. However, this still places the onus on the consumer to act. A consumer who does nothing might find that they have a considerably higher credit limit than originally applied for. The 'default option', therefore, is for them to have access to more credit – and as the Jigsaw research found, once a given amount of credit on a credit card is available, it is seen as "the amount of 'new money' available to spend", rather than debt that could be taken on but that will have to be repaid.

13. In both of these cases, consumers are strongly encouraged to take on more debt than they had originally intended. Unsolicited offers of additional credit, whether at the point of initial application or as an extension of available credit, are not unlike the

[4] https://www.fca.org.uk/static/fca/documents/research/jigsaw-research-consumercredit-overdrafts-creditcards.pdf
[5] http://www.theukcardsassociation.org.uk/wm_documents/Credit%20card%20limit%20increases.pdf

pre-filled credit card application forms that the Jigsaw research found wore consumers down and led to them making unconsidered decisions (and which should also be carefully looked at by the study). In fact, as a given credit limit will only generally be offered if the creditor is prepared to lend that amount to that consumer, it is even easier to see how consumers could find themselves in large amounts of debt without having made a considered decision to take it on.

14. We believe that, subject to the upper limit a creditor is willing to lend to them (alongside a minimum below which such lending is economically unjustifiable for the creditor), a consumer should remain in full control of their borrowing. The consumer should be responsible for determining the level of their borrowing - including initiating any increase.

Minimum payments

15. At present, an individual borrowing on a credit card is able to take out ever-increasing amounts, provided that they remain within their credit limit and make a minimum payment each month. The FCA recognised that repeatedly extending a debt can be a cause of significant detriment when it limited the number of rollovers that could be applied to payday loans to two, citing its concern that “loans that are repeatedly rolled over can lead to an unsustainable debt burden for many borrowers”[6]. We agree with this assessment, but question why its logic should apply to only a particular segment of the consumer credit market. We also think there is scope for the FCA to set out its view of what appropriate use of a credit card looks like, as it has done with payday loan products by restricting the use of rollovers (recognising that they are intended as a short-term product).

16. There are certainly rational reasons why someone would do repeatedly extend their debt on a credit card, particularly if they are taking advantage of a 0% promotional rate for balance transfers or purchases. However, it is concerning that more than a million consumers are making the minimum payments for over 12 months, and close to 700,000 are doing so for over 24 months – effectively ‘rolling over’ their debt for an extended period.

17. The FCA should, as part of its study, look closely at how consumers making multiple minimum payments are using the credit card (are they continuing to spend, or maintaining a steady balance?). It should also analyse whether those consumers making minimum payments for extended periods are on 0% deals – and for those who are, what they do once that period has expired (e.g. switch to a new card with a promotional rate, increase the balance on the card, continue to make minimum repayments, or start to pay off the balance).

18. The Jigsaw research found that many people saw the minimum payment as the cost of keeping the card ‘alive’ to the next month, rather than as a means to pay off the balance. The UK Cards Association, meanwhile, states that 56% of borrowers

[6] http://www.fca.org.uk/news/fca-confirms-price-cap-rules-for-payday-lenders

making the minimum payment at least once during a year did so because they could not afford to pay more[7] – as the minimum payment is a very small proportion of the balance outstanding, this motivation is a strong indicator of financial difficulty, and particularly if they cannot afford more than the minimum over a longer period.

19. A consumer who repeatedly pays the minimum balance on an interest-bearing credit card is in our view at clear risk of financial difficulty. We think a ‘rollover limit’ for interest-bearing credit card accounts merits consideration. This could limit the number of consecutive months that an outstanding balance could increase to six, or how many times only the minimum repayment can be made to three consecutive months or six months in any 12-month period. Consideration would then have to be given to the appropriate next step if that limit is breached – which might be referral to free debt advice, or converting the debt into an interest-free loan. An alternative option could be to increase the minimum payment to a higher percentage of the capital in certain circumstances such as those above – this increase could motivate customers to take stock of their situation.

20. We also think that waiting to intervene until there is clear evidence of financial distress is too late. It is particularly important that creditors take steps to contact and support borrowers who may be in difficulty – and this should be more than just setting out the consequences of their payment habits. The Jigsaw research highlights that some consumers saw a lack of creditor contact as an “endorsement” of their repayment habits. This lack of engagement leads to a perception of credit card debt as debt that does not have to be repaid, and could delay consumers assessing their financial situation and lead to them taking on further debt.

21. For example, if a customer repays less than 10% of the outstanding balance for more than three consecutive months or six months in any 12-month period, the lender could contact them to check how they are dealing with their credit card debt and encourage them to work out a plan to reduce the balance. As 10% of the balance is higher than the minimum payment the card would remain active even if the consumer took no action, but this contact would provide a prompt for the consumer to review their repayment habits and engage with any potential difficulties at an earlier stage.

Conclusion

22. As part of its consumer credit regulatory responsibilities, the FCA has an opportunity in this market study to address issues in the credit card market that negatively impact customers’ ability to stay on top of their money, and that ultimately could lead to them to experience financial difficulty. We have highlighted here two aspects of the current market that the FCA should look at as part of its focus on the affordability of credit card lending. We hope that the market study will consider these issues, and that the FCA will then move to address them.

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