The Money Charity response to the FCA's consultation on persistent credit card debt and earlier intervention remedies

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)

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Introduction

1. The Money Charity welcomes the FCA's proposed remedies for persistent credit card debt. Action is long overdue. The proposals outlined in this consultation can make a significant difference to millions of people who are, often unnecessarily, paying significant amounts of fees and interest using credit cards for a purpose for which they are not intended.

2. While the aim of defining persistent debt and the interventions suggested here are welcome, we believe the timescale the FCA has chosen is far too drawn out, allowing people to spend too long paying more in interest than they need to. The decision to wait 18 months before even the mildest nudge to change behaviour, and 36 months before any more concrete intervention will (as we will illustrate below), cost consumers hundreds of pounds they need not have paid, and will continue to allow companies to facilitate the growth of debt that is detrimental to consumers.

3. In addition to that, the definition of persistent debt here, while a clear advance on the present situation, still allows people to pay slightly more than minimum payments over the long term (interest + 1.5% of balance, for instance) on average sized credit card debts bearing average interest and not fall into the definition (see below). These people are slightly better off than those on minimum repayments who do pay more in interest than on the principal, but barely so. We recognise that a definition of persistent debt has to be simple and communicable, and the one chosen undoubtedly meets that test. But when these *just above minimum payment* consumers are not included, the proposed definition is not expansive enough.

4. Financial capability in the UK is low[1]. Many consumers don't fully understand the products that they are using. And in the case of credit cards this is particularly dangerous. The minimum repayment rules mean that repayments on even large balances can be rolled over at relatively low cost – but without significantly paying down the balance and incurring significant interest. So a broad swathe of credit card consumers can be lured into a vulnerable situation where they are making damaging financial decisions without it ever reaching a crisis point. We ask the FCA to look at regulations that would help this wider segment avoid taking on large debt and paying more than they have to in fees and interest.

5. The proposals here are a marginal improvement on the current situation. But the FCA presents no vision for how the credit card market ought to work. Before regulating the market, regulators ought to have an idea of what a product is for. When they were first conceived, the idea of credit cards being used as ongoing, long term debt facilities with very low levels of repayment would have been completely alien. Over time they have developed into this different kind of product through innovative practice of firms. Instead of beginning from where the market is operating and seeking marginal improvement, the FCA should work out what type of credit card market would best serve consumers and regulate from there.

[1] Financial Capability in the UK 2015

6. In the high cost, short term credit (HCSTC) market, the FCA has introduced interest rate and total repayment caps, but has tended to be far more sanguine about the £70bn credit card market. Interventions in the HCSTC market have had the effect of drastically reducing the size of that market[2], and there is clearly not the political appetite for doing the same in the credit card market.

7. However, as the Interim Report found that the market is profitable for every segment of consumers aside from those in arrears, there is much less danger of market shrinkage and waterbed effects resulting from legislation than was the case with HCSTC. Given this, we do not see justification for either the length of time before the FCA's suggested interventions or the lack of consideration of stronger interventions such as higher mandatory minimum repayments or capping total interest payments.

8. The suggested interventions themselves are welcome, but too much is left to the discretion of firms. We believe this will not provide the guarantee of protection that consumers need and facilitate an inconsistency of practice that will be difficult to communicate and will confuse consumers.

Our proposals: A higher ratio, a shorter time and a duty to monitor growing debts

9. Any definition of persistent debt is inadequate if it does not include people are paying only slightly above the legal minimum and who will be paying nearly as much in interest as they will on the balance if their behaviour does not change.

10. We argue that:
    a. The period of time over which debt is deemed persistent ought to be reduced to 6 months, with the further scheduled interventions at 12 and 18 months.
    b. The FCA ought to explore and run cost benefit analysis on higher ratios of repayment or principle to interest, ultimately adopting a stricter threshold.

11. Credit card companies should be required to monitor customers whose balance is consistently increasing month on month, and intervene even where those consumers are not paying large amounts in interest or charges.

12. The voluntary commitments of the industry to reform unsolicited credit limit increases, requiring opt-in from those who have paid minimum payments for 8 months, and cutting off all increases to those who do so for 14 months will do something to help this. But as with the other proposed rules, this only captures a small segment of consumers. Those who pay slightly more than minimum payments will not be captured, even if they are building up levels of debt they will find it difficult to repay, will be unaffected by any changes.

13. We call on the FCA to look into tightening these rules and come forward with preventative mechanisms to not only prevent consumers paying more than they have to in fees and interest, but to prevent them from building up problematic levels of debt.

[2] https://www.ft.com/content/4da29534-f9e1-11e6-bd4e-68d53499ed71

Q1. Do you agree with our proposed definition of persistent debt?

14. Drawing up a definition of persistent debt inevitably involved some arbitrary decision. Whether long term minimum payments, steadily growing debt, credit limit utilisation or paying more in interest than on the principle for a defined period, problematic and detrimental behaviours will be excluded from the classification. Having looked at the options, we conclude that the ratio of interest to principle paid by a consumer over a period is the fairest way to capture the most people whose credit card use is causing them detriment without including people whose use is rational.

15. Credit limit utilisation was never an appropriate measure of problem debt. While, as FCA research has shown, high levels of utilisation correlate strongly with other proposed definitions of persistent (and problem) debt, in and of itself having a balance that utilises most of your credit limit does not mean that there is a problem. Certain credit card deals are structured in ways that incentivise high limit utilisation, and some consumers will exhibit this behaviour without having a problem.

16. Long term minimum repayments will both exclude people who are in problem debt but making slightly higher payments, as well as wrongly include those on 0% deals who are using their cards in rational ways.

17. While those who are paying more in interest and charges than on the principle for prolonged periods of time are certainly in persistent and problematic debt, there are other groups of consumers who are also in need of regulatory protection:

    a. Those paying almost as much in interests and charges.
    b. Those who are not paying a large amount in interest and charges, but have steadily expanding level of debt that they may be unable to repay.

Illustrative examples we consider 'problematic' that fall outside the FCA's proposed definition

18. Our analysis shows that in order to pay more in interest than in repayments on the principle, consumers have to be on or near minimum repayments for the duration of the 18 month period. Any consumer who pays even slightly more than the statutory minimum will be excluded by this definition.

a. Average customer making minimum payments

19. The average credit card debt per household in March 2017 was £2,504. The average interest rate on a card bearing interest was 18.2%. If minimum payments of interest and 1% of the outstanding balance are made for the first 18 months (and there is no new spending on the card) a consumer will pay £581 in interest and £414 on the principle.

20. If this consumer continues the trend (assuming minimum payments cannot fall below £5), they will repay a total of £5,830, well over twice the original balance in the 25 years and 11 months it takes them to repay. This person is clearly suffering considerable detriment, making financial decisions that are not in their interest.

b. Average consumer makes just above minimum payments

21. Increase that payment just a little and a customer is paying interest plus 1.5% of the outstanding balance each month. In an 18 month period, they will pay £557 in interest and £596 of the principal. They will repay £4,647, were this pattern to continue over the 18 years and 10 months until the balance is cleared.

22. This consumer is not, according to the FCA's definition, in persistent debt. While this second consumer is obviously in a better situation than the former who falls into the FCA's definition, it's difficult to argue that they are not in significant detriment in this situation.

c. Consumers who are building up unmanageable debt, but not paying high interest

23. There are currently cards on the market with 30+ months of 0% on purchases or balance transfers, and this makes it very possible for consumers to build high balances on credit cards without paying a large amount in interest or fees. If a consumer builds up thousands of pounds in debt over a long period, even if they are not paying huge sums of interest, they can be storing up problems for the future, and need regulatory protection.

24. We do not have the resources to match the FCA in analysing different options for regulations that could capture all of these groups. But if consumers are to get the protection they need against falling into problematic debt, regulation has to have a wider target than currently proposed. Below are our suggestions for definitions that could address this shortfall.

A different ratio

25. Without resorting to complex definitions using algorithms impossible to clearly communicate to consumers, the ratio of interest paid versus the amount paid on the principal is the best available definition. However, we argue that using a ratio of 1:1 over an 18 month period before any intervention allows consumers to engage in too much detrimental credit use over too long a period.

26. Our analysis, above, shows that this 1:1 ratio would allow a consumer to make payments only slightly above the legal minimum, paying almost as much in interest as they did back on an average debt. Just as for those consumers paying more in interest than on the principle, the overwhelming majority of these consumers will either be able to make larger repayments or refinance and pay less in interest.

27. Given the acceptance that:

    'We expect that in many cases the difference in circumstances between customers who can just about afford the minimum repayment and customers who cannot quite afford it is not likely to be significant….'

    the FCA should also recognise that there is no huge gulf between those who can afford minimum repayments and the cohort just above this. Accordingly, a stricter definition should be set.

28. The FCA should study the likely effects of stricter ratios with a view to adopting a measure that would also help consumers who are paying back just enough to remain clear of the currently proposed definition.

Six, not 18 months to intervene

29. In addition, the FCA has been too conservative with the timings it has chosen for its interventions, and has not sufficiently justified waiting 18 months before making a suggestion of behavioural change and three years before any more concrete intervention. Justifications for such a long time period - that it contains two Christmases and a summer – is not an adequate explanation for an 18 month period.

30. In further conversation with the FCA, it emerged that the second reason for an 18 month period before intervention is that 18 months is the period at which persistent debt crystallises. Prior to that, many consumers change their behaviour without prompt, but afterwards most consumers retain similar patterns of behaviour. The initial intervention is not severe and is intended only to remind people that they ought to consider increasing the rate of payment or refinance their deal. Given that it is a nudge, we see no reason why it should not take place after a shorter period such as 6 months.

31. If a consumer who would have changed their payment patterns after 8 months, we do not see a problem if they are superfluously prompted to change behaviour at 6 months.

32. There is a view we have heard expressed during this consultation period that because minimum repayments are a flexible feature that consumers value and have come to expect from credit cards, regulators should not intervene to warn consumers off using them for prolonged period of time. We recognise that consumers should not be forced to repay at higher rates when they have entered into contracts which allow minimum repayments (at least until a significant time has elapsed). But this does not preclude nudges and warnings that consumers are paying more than they need to in interest and fees and encouraging them to increase their rate of repayment.

Q2: Do you agree with our proposal for intervention at 18 and 27 months?

33. We continue to have reservations about the timings of the interventions and would prefer that this second and third intervention happened after 12 and 18 months respectively. So the interventions would be as follows:
    a. 6 months (for the proposed 18 month intervention)
    b. 12 months (for the proposed 27 month intervention)
    c. 18 months (for the proposed 36 month intervention)

34. Overlong timescales aside, the intervention itself is welcome. In effect, these are only nudges to change behaviours which, by 18 (we recommend 6) and 27 (12) months, will be putting the vast majority of consumers in a situation where they are paying more interest than they need to.

Q3: Do you agree with our proposals for intervention after 36 months of persistent debt for those customers that can afford to repay more quickly?

35. We welcome the interventions proposed at 36 (we recommend 18) months. If, after two warnings, a consumer is still in persistent debt they are almost certainly making unnecessarily damaging decisions about their finances or are in a situation where they cannot handle their debts.

36. For these consumers, agreements to pay down the balance over a shorter time, and for forbearance to be on offer to those who are unable to meet the increased payments requires is an appropriate and helpful intervention.

37. The suggestions outlined for this final intervention are just that, *suggestions*. From what we can tell, firms will not have prescription on how or whether to offer forbearance, precisely what constitutes a reasonable time over which a debt needs to be repaid, or how exactly to manage the ongoing credit facility. Though we understand the theory of allowing flexibility for firms who will have more information about individual customers, this lack of prescription will allow a wide range of practice and fail to guarantee consumers will actually be given the forbearance and other interventions that could protect them.

38. We worry about this for the following reasons:

    a. Firms will still be able to make decisions based on maximising profitability (lengthening repayment periods, avoiding forbearance…) rather than on ensuring consumers are on a fair plan to pay down their balance.
    b. Consumers need to be able to understand the features of the financial products they use. Over time, the conversion of persistent debts into term loans could become a well understood feature of credit cards. However, if practice is allowed to vary widely between firms, it will undermine public understanding.

39. We agree with the proposals outlined here, but recommend that the FCA makes them more prescriptive for firms and guarantees consumers these protections.

Q4: Do you agree that three to four years is a reasonable period over which firms must help customers repay the balance?

40. As a rule of thumb, a three to four year period to pay down the balance on a card is reasonable. If a consumer is unable to pay off their balance within that period, they probably require some degree of forbearance. It equates to a typical personal loan repayment period, and any customers who cannot repay their credit card balance in this time are in problem debt.

Q5: Do you agree with our proposal for a requirement to exercise forbearance and due consideration for customers in persistent debt who cannot sustainably repay more quickly?

41. Where a consumer is unable to repay a debt in period of three to four years, forbearance should be required. If a debt is so large, and finances so tight that repayment within this timescale is impossible, longer periods of repayment, or continuing minimum repayments, should not be allowed to continue to disguise financial difficulties.

Q6: Do you agree with our proposals regarding suspending use of the credit card?

42. In order for the interventions proposed to have teeth, they must include the provision that firms can suspend the cards of those who do not engage.

43. We also welcome the proposed freeze on cards of customers who have been offered forbearance. Although some consumers are reliant in the short term on credit, at some point intervention must be made to prevent further growth of card balances for those who cannot afford their debts. Given that there is no one size fits all right answer to whether to freeze a card, it is sensible, as suggested, to offer firms some flexibility on whether cards of consumers who are engaging and who have agreed a repayment plan will be frozen.

44. Converting debt into term loans should not free up credit for consumers to use, and the balance of the loan should be counted as balance on the card. The FCA's plans on this are not currently clear.

Q7: Do you agree with our proposals for customers who do not engage at 36 months?

45. We support the proposals outlined. Where a consumer does not engage, it is impractical to expect companies to unilaterally convert balances into instalment loans repaid over a shorter period. However, unless and until a consumer engages, the use of a card should not be available to them.

Q8: Do you have any views on the potential need for novation of existing contracts or modifying agreements in order to suspend or cancel customers' use of their card, provide forbearance or put in place a repayment plan?

46. The novation of contracts will be a necessary part of any intervention that changes repayments or freezes cards. Given that we support the interventions proposed, we

understand that firms must have provisions to rewrite contracts where this does not already exist.

Q9: Do you agree with our proposal that the firm must treat a customer with forbearance where the customer is unlikely to repay the balance in a reasonable period under a repayment arrangement?

47. Forbearance should be mandated where firms cannot expect customers to repay within the 3 or 4 year time periods. In a situation where a customer is unable to meet the repayment schedule, either because their financial situation has deteriorated, or because the original payment schedule was unaffordable, forbearance will be necessary.

Q10: Do you agree with our proposals for commencement of the Handbook provisions?

48. We strongly approve of the decision not to wait for 18 months from the moment the rules are written into the Handbook before making any assessment of persistent debt. The provision that firms look back from the date three months after the rules come into force seems reasonable and will helpfully fast track interventions.

Q11: Do you agree with our proposals regarding interaction between persistent debt, earlier intervention and CONC 7.3.4R?

49. We agree with the proposals regarding interactions. The creation of persistent debt interventions should not undercut pre-existing CONC provisions.

Q12: Do you agree with our proposal to require credit card firms to monitor other data in addition to a customer's repayment record?

50. It is important for firms to take into account where a consumers' wider financial situation when making decisions about forbearance, repayment plans and cutting off credit. Where possible, firms should use the data that is available to them.

Q13: Do you agree firms should be required to take appropriate action where there are signs of actual or possible financial difficulties? + Q14: Do you agree that signs of actual or possible financial difficulties should include where there is a significant risk of one of the matters in CONC 1.3.1G occurring?

51. We support this approach. Firms should be required to look at customers' wider financial difficulties and described in here, not simply their behaviour with regards to a single credit card.

Q15: Do you agree with the proposed examples in guidance in CONC on what may constitute appropriate action where a customer is showing signs of actual or possible financial difficulties?

52. The proposed guidance in CONC is appropriate for customers showing signs of financial difficulty.