Briefing Document

StepChange Debt Charity response to the Financial Conduct Authority credit card market study interim report

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Introduction and general comments

StepChange Debt Charity is the largest specialist debt advice charity helping people across the UK. In 2015 over half a million people contacted our free telephone helpline or online debt remedy tool for advice on problem debt.

We very much welcome this study into the credit card market. Credit cards remain a significant part of the consumer credit debt problems that StepChange Debt Charity clients face. Figures from for first half of 2015 show that:

- 65% of people seeking advice from StepChange Debt Charity had one or more credit cards.
- Credit card debt made up around 38% of all the debt we dealt with.
- The average credit card debt of our clients was nearly £8,500. This has declined in recent years, but remains large.
- Multiple credit card debt remains common. 42% of our clients had more than one credit card debt, a quarter had three or more, and 14% had four or more credit card debts.
- StepChange Debt Charity clients with credit cards held between two and three (2.5) cards on average
- The average total outstanding debt (credit cards and other debts) of StepChange Debt Charity clients stood at just under £15,000. They had just fewer than six debts on average.

StepChange Debt Charity believes that credit cards provide a useful and valued service for consumers and we agree with the findings of this interim report that consumers value the flexibility offered by credit cards. However we note that the ways consumers can use this flexibility (as described in the executive summary) can led to consumer detriment:

Credit cards allow people to spread the cost of purchases, but people can build up large balance and underestimate the vulnerability to financial difficulties this creates.

People can use credit cards as an emergency credit facility, but this can lead people further into serious financial difficulties. Our research estimates that some 14 million people faced at least one income shock or significant change in circumstances in the previous 12 months. Around 6.5 million of these used credit as a part of their coping strategy. Some 1.7 million of those people that used credit to manage a change of circumstances in the previous 12 months fell into problem debt. This compares to 135,000 people who did not use credit to cope. While 'emergency credit' may help some consumers to manage through temporary cash flow problems, it can also help make financial difficulties become more severe.

People can use credit cards to pay off other debt, but ‘juggling’ credit commitments can also push people further into unmanageable debt. Here we note that StepChange clients with multiple credit cards tend to have have much larger credit card debts. While the average credit card debt of people with one card is around £3,000, the average credit card debt of people with five credit cards is around £18,000. The average balance on each card also tends to rise as more credit cards are held.

So we are keen that this review should seek to understand the causes of consumer detriment and the conditions under which it grows.

We hoped that the review would deliver a clear view on the scale and nature of credit card debt and vulnerability to credit card debt in the UK. The report appears to do this and the findings on the extent of severe arrears and persistent payment pressures are both important and concerning.

We were expecting analysis on the features of the market and products that can drive credit card debt. The finding that in most of the market competition is working fairly well for consumers is welcome. However it seems clear that some features of the credit card market are failing consumers and that the market is not working as well for some consumers, including those at higher risk of financial difficulty. We hope that the final report will increase the focus on these issues.

The report highlights problems with small print and illegible product info (para 4.10). While this in not a conduct review as such, we would urge the FCA to look further into the detail of contract terms and product features that could cause consumer detriment.

We hoped that this review would shed light on the role of **multiple credit cards** in debt problems and how multiple credit card debt problems build over time. But this is not covered in the interim report in what looks to us like a serious omission. So we strongly urge the FCA to cover this in further research before the final report in published.

We believe that a key output from this review should be effective remedies to long standing problems in the credit card market. Here we note that some of the issues covered in the interim report were also explored in the 2010 review of the credit card market carried out by the Department for Business, Innovation and Skills.

The remedies proposed by that review have delivered some positive benefits for consumers; but they have not been successful in eliminating problems highlighted again in this review. We would ask the FCA to consider the effectiveness of past approaches when finalising remedies arising from this review.

Comments on conclusions remedies and issues

StepChange Debt Charity has comments and suggestions on the conclusions and remedies of the interim report as follows:

Competition and market functioning issues

StepChange Debt Charity welcomes the remedies set out in the interim report that aim to improve the likelihood that consumers taking out a credit card will get both a product most suited to their needs and a good deal.

The proposal to **allow consumers to open access to their credit card usage data** sounds reasonable. However given that this review finds a number of issues limiting the effectiveness of price comparison sites (and noting the concerns raised elsewhere on the conduct of PCW's comparing high cost credit products), the proposal to develop clearer standards for PCW's comparing credit cards seems both sensible and necessary.

However, that consumers can struggle with product complexity is a recurring and persistent theme in credit and related retail financial services markets. We would urge the FCA to consider whether better standards for PCWs will be sufficient to avoid consumer detriment, or whether more needs to be done to reduce the complexity of the decisions the market is asking consumers to make.

We welcome the **proposal to facilitate the use of quotation searches**. We note the finding that consumers may not get the headline offer rate listed in price comparison sites and may be reluctant to seek a quotation for fear of damaging their credit rating. Our own research has found evidence that consumers' fear of damaging their credit rating can drive behaviour that causes longer term detriment.

For instance in a survey of StepChange Debt Charity clients, 53% said they were struggling with their debts for over a year before seeking advice. A quarter of these said that had not sought debt advice earlier because they were worried that it would affect their credit rating badly or reduce access to credit.

However the findings of the interim report also suggest that concerns about access to credit may have a wider effect on competition. More financially vulnerable and less experienced consumers are more focused on likelihood of acceptance rather than price (para 4.19) and gave access concerns as the most common reason for not shopping around (para 448). These consumers were also most likely to receive unsolicited marketing and had a more limited choice of products.

Here we also note the finding that returns on higher risk credit card products were on average higher, typically by about 6%.

This suggests that the credit card market is not working well for consumers who are more vulnerable to financial difficulties. We would ask the FCA to increase the focus on this part of the market in the final report; as it is not clear that the remedies proposed so far will be sufficient to get better outcomes for more vulnerable consumers. In particular we believe the final report might address the following:

- The relationship between price and risk - are higher risk borrowers being charged too much because completion is impaired.
- We note the finding in Annex 6 that some lower risk borrowers may be using higher risk cards, leading to high returns for lenders. Does this suggest the need for clearer and better explanations about product suitability and the way risk based pricing works?
- Whether targeting of unsolicited marketing at higher risk consumers limits shopping around and creates consumer detriment
- Whether the current proposed remedies will be sufficient to ensure the market works well for all consumers.

Finally, we support the proposal to explore how firms might give consumers **better notice that promotional periods are about to end**.

Affordability and problem debt

StepChange Debt Charity warmly welcomes the focus in this review on affordability and problem debt. Our comments in response to the proposed remedies are as follows:

We note the proposals relating to **under-repayment**. These focus on giving consumers better disclosure and / or a wider range of repayment options. Here we would raise a concern that these remedies may not deal with the problem identified in the interim report. The 2010 credit card review sought to address concerns about persistent minimum repayments with similar remedies. There was an agreement (now replicated in 6.7.5R) that a minimum repayment should cover interest, charges and at least 1 per cent of the amount outstanding. This was supported by better disclosure provisions.

We understand this has had some positive effects, but clearly not enough to deal with the problem. This credit card review finds 1.6 million people repeatedly making minimum repayments and 5.1 million accounts that will take more than 10 years to pay off the balance.

We would urge the FCA to consider the case for strengthening the requirements on minimum repayments. Our rough calculations suggest that some relatively gentle changes to the minimum repayment requirements could drastically reduce the period of repayment without significantly increasing the size of the minimum repayment itself.

We estimated that someone just making minimum payments on a £1,000 balance on a standard interest rate card, assuming no further borrowing, could take up to 18 years to pay down the balance.

Using the same assumptions, but fixing the minimum repayment at the level of the minimum repayment at the start of the series could reduce the pay down period to around five years.

Fixing the minimum repayment as above and increasing the minimum repayment to include a 2% reduction of the balance outstanding (rather than 1%) could reduce the repayment period to just over three years. This would only result in a £10 increase in the minimum payment level at this level of outstanding balance.

These suggestions serve to illustrate how a more direct intervention on the way the minimum payment is set is more likely to provide an effective remedy than another round of information notices.

Increasing the per cent pay down requirement would also have the virtue of linking repayments more closely to the amount borrowed in a way that should encourage responsible lending and borrowing.

We strongly support the proposal to **require consumers to actively opt in to credit limit increases** and **choose their payment date**. These seem sensible proposals to give consumers more control.

We note that the report finds two million people in serious arrears and another two million with persistent credit card debt. The report also that the **affordability tests** firms conduct are noticeably less sophisticated than the creditworthiness tests they carry out. Following maxim that credit risk tests broadly protect the firm and affordability tests broadly protect the borrower, this should be of some concern. Yet there is nothing specific in the proposed remedy package on strengthening affordability tests.

We note the finding that creditors are incentivised not to lend to borrowers likely to default. But in contrast, Annex six suggests that lenders can make a positive return at nearly every risk level for low risk product and at high risk levels for higher risk products. As the executive summary points out, consumers with persistent levels of debt or making minimum repayments are profitable. So firms may not be sufficiently dis-incentivised to ensure affordability testing is robust enough to protect borrowers against a heavy debt burden.

Therefore we ask the FCA to consider what more could be done to improve the sophistication of affordability checks.

The remedy package does not say anything about **default fees and charges**, despite the finding that these fees provide around 9% of total income for higher risk cards. In particular we note the finding that credit builder ‘low and grow’ cards are likely to have a higher proportion of income from interest and fees.

Given that low and grow cards are aimed at less experienced consumers and people more vulnerable to financial difficulty it is concerning that default fee incomes tend to be higher.

This suggests that these cards are not necessarily suited to the needs of these borrowers and not always helping borrowers to build a good credit record. We urge the FCA to look further into the product features and lending practices associated with these cards.

Finally we strongly support proposals for **earlier forbearance**. We note the finding that firms are generally pro-active with forbearance where consumers begin to miss payments; but there is less evidence of proactive help where borrowers are meeting repayments but otherwise showing signs of financial difficulty.

This resonates with the experience of our clients.

Around 50% of StepChange Debt Charity clients are referred to us by one of their creditors. We work very closely with a number of lenders on helping people to engage with the debt advice they need. There is undoubtedly some very good practice in the market where firms are helping their customers in payment difficulties.

But at the same time our research finds consumers who proactively ask firms for help with problem debt do not always get the help they need.

A survey of StepChange Debt Charity clients found that 80% of had contacted their creditors for help with problem debt. But nearly a third of those with credit debts said that none of their creditors would help by freezing interest, charges or enforcement action. Six out of ten of those not shown forbearance by their creditors went on to take out more credit to try to cope with their debt problems.

Even after debt advice, 43% said some or all of their creditors continued to add charges and 53% said some or all creditors continued to add interest. So the forbearance offered to people in apparent financial difficulties is not always complete or consistent.

This does not subtract from the good practice we see, such as pre-arrears approaches that try to help borrowers before they get into serious problem debt. But it highlights the need for the FCA to look more closely at forbearance practices to ensure they are effective and constantly applied.

So we strongly support the proposal to explore ways to manage consumers out of persistent debt, perhaps by migrating them to an alternative lower cost credit product.

In addition we would urge the FCA to look at how firms can be encouraged to get people in financial difficulty to the help they need more quickly. StepChange Debt Charity would welcome the opportunity to help the FCA's work in this area.

We would also urge the FCA to consider whether the CONC rules (and other consumer protections) need to be strengthened to ensure that people struggling with problem debt get the help and forbearance they need from all of their their creditors on a consistent basis. If one creditor does not help, the good practice of other creditors can be undermined.

Insight from our clients strongly suggests that a clearer and stronger guarantee of forbearance would be likely to encourage people in financial difficulties to seek debt advice earlier.

When asked what would have encouraged them to seek debt advice earlier than they did, two thirds of StepChange clients chose the answer 'knowing that getting advice could stop interest, charges, and other collection action and help me make lower payments for a temporary period'; half answered 'knowing that I had a right to temporary help from my creditors if I asked'; and 45% answered 'clear information from my creditors about the help they could offer'.

We would hope that the remedy package in the final report has more detailed and developed proposals on forbearance.