

# Consultation Response



Credit card market study: Consultation on persistent debt and earlier intervention remedies

StepChange Debt Charity consultation response to the Financial Conduct Authority

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## Introduction

StepChange Debt Charity is the largest specialist debt advice charity helping people across the UK. In 2016 we were contacted by almost 600,000 people seeking debt advice.

We welcome the opportunity to respond to this consultation as credit cards remain a significant part of the consumer credit debt problems that our clients face. In 2016:

- More than two thirds (67%) of people seeking advice from StepChange Debt Charity had one or more credit cards.
- Credit card debt made up around 40.5% of all the debt we dealt with.
- The average credit card debt of our clients was just over £8,300. This has declined in recent years, but remains large.
- StepChange Debt Charity clients with credit cards held between two and three (2.6) cards on average
- Multiple credit card debt remains common. 44.4% of our clients had more than one credit card debt, more than a quarter (26.9%) had three or more, and 15% had four or more credit card debts.

## General comments

Firstly, we would raise a question about the transparency of why and how these remedies were decided upon. The FCA mission states that the FCA aims to be more transparent in general and in particular to be transparent about how regulatory judgements are made. The persistent debt remedy with interventions at 18 and 36 months in this consultation paper is the only solution presented and modelled. There is not any comparison with other potential remedies or discussion as to what other options were considered or modelled. There is also not enough detail on what the remedies are aiming to achieve in terms of an appropriate level of consumer protection. The consultation paper outlines some general aims to address the consumer detriment arising from using a credit card for long-term borrowing including that customers may pay very high costs to service their debts. However, it does not outline clearly what is considered the desirable level of consumer protection to prevent customers falling into and helping customers out of persistent debt.

Moreover, we set out below an illustration of different pay down approaches that suggests other minimum repayment remedies could achieve the aim of addressing persistent overdraft debt more effectively and with less risk of negative impact on consumers.

The table below models other potential remedies in comparison with the current situation of minimum repayments and a minimum repayment based around the proposed persistent debt threshold. These are all based on a starting balance of £3,000 balance and a borrowing rate of 1.456% (18.9%APR). The table shows estimates of the balance remaining and interest paid 36 months later. It also estimates how long the balance would take to clear. This assumes no further borrowing and no additional charges added to the balance.

Minimum repayment in place at month 1	Balance remaining 36 months	Interest paid at 36 months	Time to clear balance (no other intervention)
Current situation: Minimum payment now	£2,089	£1,326	Over 72 months
Move minimum repayment to proposed persistent debt threshold at month 18	£1,922	£1,303	Over 72 months
FCA proposed remedy: Move minimum payment to persistent debt threshold from month 1	£1,769	£1,230	Over 72 months
Fix existing minimum payment at month 1 level	£1,593	£1,245	62 months
Fix persistent debt threshold minimum payment at month 1 level	£9,52	£10,96	47 months
2% pay down rate	£1,449	£1,128	Over 72 months
2% pay down fixed and month 1 level	£186	£919	37 months

This modelling suggests that FCA proposed remedy (as in figure 2 on page 25 of the consultation paper) will result in slightly less interest repaid but a still significant time to repay the balance (over 72 months). Therefore it is not significantly different to the current situation which would also take longer than 72 months to repay.

In contrast, some other solutions lead to a reduced time to clear the balance including fixing existing minimum payment at month 1 level (at 62 months) and fixing persistent debt threshold minimum payment at month 1 level (at 47 months). The 2% pay down fixed at month 1 level solution would lead to the balance being repaid in 37 months.

So the proposed intervention at 18 months (if this leads to people paying at the persistent debt threshold) seem little better than the current minimum repayment requirements. This perhaps explains the similarity of the two curves in Figure 2 of the consultation paper.

This suggests that any of the above remedies would be effective in speeding up pay down and reducing borrowing costs, if applied earlier than 18 months into a period of persistent credit card debt. It also suggests that requiring lenders to fix minimum repayments at the month 1 level could help borrowers to clear balances more quickly and with less negative impact than under the 36 month remedies proposed in this consultation. This would not necessarily need borrowers to increase the level of repayment above that month one level. Instead a minimum payment on this basis progressively allocates more of the repayment to pay down. The point here is that requiring firms to change their minimum repayment provisions could be more effective than relying solely on consumers to change their repayment behaviour.

We acknowledge that the FCA is undertaking behavioural trials to test the effect of different ways of presenting repayment options and that this may involve options including increases to minimum repayments. However, alternative remedies focused on changing minimum

repayments might be more effective. We also understand that the FCA considers a change to minimum repayments to be a change in contract including of existing contracts which could make it more difficult to afford for some consumers. However, we would suggest that the persistent debt remedy as presented also includes an effective change of contract as some of those in persistent debt for 36 month will be required to repay within a fixed term of a further 3-4 years.

More generally, our concern (as outlined in responses to questions below) is that the consumer detriment and high cost of using credit cards for long-term borrowing will not be adequately addressed by the proposed remedies:

- Those who can repay more quickly and come out of the definition of persistent debt between 18 and 36 month, could still be repaying their balances over a considerable period of time e.g. over ten years.
- There may not be a suitable option offered to consumers who cannot afford to repay more quickly but could repay in a reasonable period if they are offered a lower interest rate and/or a monthly payment amount. As there is no requirement on firms to offer customers the quickest and most affordable way to repay.
- Those who cannot afford to make repayments should be offered forbearance. However, there is a concern that relying on existing forbearance rules will not go far enough as our clients experience indicates forbearance is currently not always consistently and effectively applied.

There is also a question about whether the early intervention and persistent debt remedies are sufficiently aligned. The early intervention remedy is focused on preventing financial difficulties from occurring at an earlier stage which is welcome. However, the early intervention remedy does not provide a mechanism for intervening early to prevent persistent debt, which is associated with financial difficulties. For greater alignment, we would recommend that being at significant risk of being in persistent debt should be another sign that can trigger early intervention action.

We acknowledge that the FCA is undertaking work separately on creditworthiness and affordability assessments. We would urge this work to be taken forward as soon as possible, because getting affordability right at the outset of a credit agreement is a key part of preventing persistent debt. The high levels of consumers in persistent debt (over 4 million) suggests that affordability assessments are currently not working effectively and the FCA should consider what needs to be done to improve the sophistication of affordability checks. A starting point of this could be to better define what constitutes a 'reasonable period' in CONC responsible lending rules following this consultation e.g. a period of longer than 36 months (or 18 months) at minimum repayments would be unreasonable.

## Persistent debt

### **Q1: Do you agree with our proposed definition of persistent debt?**

The proposed definition in this consultation is an operational definition as it allows firms to identify those coming under this definition relatively easy in order to trigger the interventions at 18, 27/28 and 36 months. However, we are concerned that the definition presented in the consultation paper does not capture all consumers that could be considered to be in persistent debt as it does not capture some consumer who will take more than ten years to pay off their balances. Figure 2 (page 25 of the consultation paper) suggests that some accounts that who have exited persistent debt by this definition between the 18 months and 36 months will still be paying off their balance over more than ten years (between 2019-2030).

The consultation paper outlines that an estimated 11% of accounts would no longer be caught by the definition at 36 months but could still be paying off for over ten years. The final report of the credit card market study highlighted evidence of persistent debt being that nearly 5.1 million accounts (active in January 2015) would take more than ten years to pay off their balances. Despite this, under the definition in the consultation paper some customers will not be considered to be in persistent debt but will still be repaying their balances off over more than ten years.

This definition of persistent debt captures accounts where the ratio of repayment of principal to payment of interest and charges is over 1 in any 18 month period. However, the consultation paper does not present any other modelling of other ratios, for example, over 0.5 or 0.8 rather than 1. This raises the question of why the ratio was set at over 1. Without modelling of alternative lower ratios we cannot assess whether the ratio of over 1 is appropriate. We can only raise the question of whether a different ratio may be a better definition of persistent debt and capture more accounts that are repaying over a long period of time.

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

The interventions at 18 months and 27 months are effectively information remedies. At 18 months (and 27 months) once they have been provided with the information the onus is then placed on the consumer to engage with this information. The consultation paper has low expectations of who will engage and be able to make a change before 36 months, 11% of accounts are expected to 'exit persistent debt' between 18-36 months. In contrast, a requirement on firms to change minimum repayment terms could benefit all credit card borrowers with quicker pay down and lower cost of borrowing. It is difficult to see how the proposed 18 month informational remedy is the best option available to deliver an appropriate level of consumer protection.

Our concern with the 18 month and 27 month interventions is that there does not seem to be a suitable option for those who can only afford to repay the minimum repayment so cannot repay more quickly but do not need debt advice. Even if they contact their provider, there is no incentive on the firms to make it easier for them to repay at this stage. Firms have little incentive to offer forbearance to customers in persistent debt at 18 months as if these customers continue to make the minimum repayments for another 18 months they will continue to be profitable. There seems to be a disjuncture between the CONC rules on

forbearance and the 18 month intervention as lenders are not required to consider persistent debt as a sign of financial difficulty despite evidence associating it with payment difficulties (as presented in footnote 39 on page 55 of the consultation paper).

At 18 months, there is no requirement on the firm to provide a way for customers to repay their balance within a reasonable period. As a result the consultation estimates that a number of consumers will continue to make contractual minimum repayments for a further 18 months before a more effective intervention at 36 months.

Given that the cost benefit analysis suggests there is a large cohort of borrowers still in persistent debt at 36 months who could afford to pay down more quickly. We would ask the FCA to consider moving the 36 month remedy forward to 18 months to deliver a reasonable pay down period for credit card borrowing.

We would also suggest that the information and warnings about persistent debt should come before customers have gotten into this position so before 18 months. This would then act as more of an early intervention measure to encourage people to repay their balances more quickly before it becomes a persistent debt problem. Firms would then be required to help customers repay in a reasonable period when they are in persistent debt which is defined as paying more in interest and charges than in principal at 18 months.

Another additional question is why the second information remedy (prompt at 27 months) is nearly 10 months after the initial information is provided. Why is this second prompt also not at an earlier stage?

### **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?**

We are concerned that there is no clear guidance, detail or prescription of what firms should do at the 36 month point. The requirement is on firms to contact customers and offer them a way/choice of ways to repay their balance in a reasonable period (3-4 years) if they can afford it. Therefore it is up to the firms to decide whether a customer can afford to repay in a reasonable period or should be offered forbearance.

We are concerned that there is still an incentive on firms to decide customers can afford to repay more quickly rather than offering forbearance as this is the most profitable approach. There is also an incentive on customers to say that they can afford to repay within 3-4 years so that they will not lose their card or be 'reported' to a credit reference agency. Consumers not offered a more suitable option, such as a reduction in interest rates or appropriate forbearance, could fall into serious financial difficulties as a result.

There therefore needs to be more of an incentive or requirement on lenders to agree a suitable option for customers in these circumstances. The principle of suitability is well established in CONC including in:

- 3.8.2 R (3) that states that in order not to avoid unfair business practices, a firm must not promote credit that they know would be unsuitable for that customer in a financial promotion or communication.
- In relation to high-cost short-term credit (HCSTC) - under CONC 3.8.3G (2) a credit agreement is likely to be unsuitable where a firm 'promotes, suggests or advises taking out HCSTC which would be expensive as a means of longer term borrowing, as being suitable for sustained borrowing over a longer period'.

The persistent debt remedy as proposed suggest that the product as it is currently structured is no longer suitable for some consumers at 36 months so a change is needed. However, there is no requirement on firms to act on what might be suitable (unlike in the examples above on HCSTC). More suitable options for customers in this position would be to have an affordable repayment plan and/or to adjust the interest rate, including a 0% interest rate if required, to allow these customers to repay in a reasonable period. A comparable example would be time orders under the Consumer Credit Act 1974, that give more time to pay a credit agreement by changing either the amount paid each month and/or how the agreement lasts, as well as, sometimes including a change to the interest rate.

Here we would also point out that a borrower with a £3,000 credit card balance would likely have paid more interest after 36 months of minimum repayments than if they had taken a £3,000 term loan. Given the return that the lender will already have had on this borrowing, is it reasonable for firms to continue to charge short term borrowing rates for a further 3-4 year pay down period?

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

We agree that 3 years might be considered a reasonable period to repay credit card borrowing. However, the remedies in the consultation paper have consumers repaying their balances over a much longer period than 3-4 years.

- For those borrowers who 'exit persistent debt' between 18-36 months will be repaying their balance over 10+ years (figure 2, page 25).
- Those who cannot or do not repay more between 18-36 months and then are judged to be able to repay over an additional 3-4 years, will be repaying their balances off over a 6-7 year period in total.

As the consultation paper states 'credit cards are suited to short-term borrowing and can be an expensive way of borrowing large amounts over an extended period'. The question is whether repaying over 6/7-10 years is considered a reasonable period. One of the original issues identified (in the CCMS final report) was that too many accounts will take more than ten years to pay off their balance. Therefore the remedies presented in the consultation that will only reduce this pay down period to 6-7 years for many accounts (and still remain at over 10 for some accounts) are not going far enough. We have suggested that information and warnings could be offered at pre-18 months point (e.g. 10 or 12 months) and at the 18 month point customers should be offered a reasonable period (3-4 years) to repay. This would mean that more customers should be able to repay their balances in a more 'reasonable period' of 4 ½ - 5 ½ years rather than 6-10+ years.

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

As outlined above, how those customers in the 3-4 year repayment plan are treated by firms is critical. We agree that firms should be required to exercise forbearance and due consideration for those who cannot sustainably repay more quickly. However, firms may not offer adequate forbearance as they will still be driven by their commercial incentives. These remedies rely on the existing CONC forbearance rules. However, our research indicates that currently customers who ask firms for help with problem debt are not always

getting 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.

The consultation paper (paragraph 2.36) suggests that where a customer confirms that they cannot afford any of the options proposed by firms or if they fail to make agreed repayments then the firm is required to treat the customer with forbearance. However, as our evidence above suggests, many of our clients who contacted their creditors about their financial difficulties were not shown adequate forbearance and were driven to take out more credit to cope. Therefore we are concerned that relying on existing forbearance rules may not be effective.

Although some firms do operate good practice, our client's experiences highlight the need for the FCA to consider whether existing forbearance practices are effective and constantly applied. We would urge the FCA to consider whether the CONC rules on forbearance need to be strengthened to ensure that those consumers who are in persistent debt (at both 18 months and 36 months) get the help they need. Clearer and stronger guarantee of forbearance would be likely to help more consumers repay their balances affordably over 3-4 years and encourage those in financial difficulties to seek debt advice earlier. These strengthen forbearance rules could include requiring firms to ensure customers are offered the quickest and most affordable way of repaying.

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

We agree that at 36 months, consumers who are in forbearance because they cannot afford to repay or those that do not respond to warnings about persistent credit card debt should not be allowed to borrow further on that card. If consumers are already struggling to repay their credit balances, further credit card borrowing is unlikely to be suitable or sustainable.

However, we do have reservations about the suspension of the use of the card being reported to credit reference agencies (CRAs). Firstly because this is not treating customers fairly, as customers will have been meeting the terms and conditions of the credit product over the 36 month period and then will be asked to repay more or go into forbearance. If they cannot afford to repay more at 36 months they should not be reported to CRAs as this expectation is not in the terms and conditions of the product.

Reporting suspension of the card to CRAs could also create perverse incentives. It could encourage/scare customers who cannot afford it to repay more quickly to make unaffordable repayments, or borrow elsewhere to fill the gap in household budgets in an effort to avoid being reported to a CRA. Repeated surveys of StepChange clients highlight worries about perceived damage to credit ratings acting as a barrier to addressing problem debt. This may be in the interest of firms but is not in the interest of consumers. We believe suspension of the use of the credit card is enough of an incentive for consumers to address the issue of persistent debt.

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

Getting consumers to engage can be a significantly challenging and complex task as households at risk of financial difficulties will have a range of priorities and demands on their time. This raises the question of why the remedies proposed here are mainly focused on consumer engagement rather than placing the duty on firms to set their products up in a way that treats customers differently. The concern is that placing so much emphasis on getting consumers to engage could drive negative behaviours that could lead to further financial problems. For example, incentivising customers to say they can afford an unsustainable repayment rate so they do not lose the use of their credit card.

The consultation paper states that there will be no specific requirement on firms in relation to the outstanding balances of customers who do not engage (paragraph 2.49). Their card use will be suspended but the firm can continue to charge interest and charges at the same rate. However, this fails to address potential vulnerability of these consumers. There may be a variety of reasons why customers do not engage, for example, they may have vulnerabilities such as mental health problems or be going through a family crisis. There is also no responsibility placed on firms to take action to prevent the continual build-up of persistent debt that they have let happen over the previous 36 months. This does not fit with requirements to treat customers fairly and other principles around providing suitable options for consumers. We think there should be more expectations on firms to look at the data available for customers who are not engaging at 36 month in order to establish if they are at risk of financial difficulties and consider forbearance for those customers who are.

**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?**

The implementation of these remedies means a change to the terms and conditions of the lending at 36 month intervention and effectively creates a new product, a medium-long (3-4 year) term credit product rather than a revolving short-term credit card borrowing. Therefore there may well be a need for a new contracts or modifying agreements to suspend/cancel card use, provide forbearance or put in place a repayment plan. These further highlights the need for firms to offer a 'new product' that is suitable and sustainable. This should include a requirement on firms to reduce or suspend further interest payments where this would make pay down affordable in a reasonable period.

**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?**

We agree that if a customer misses repayments in a pattern that suggests they will probably not repay in a reasonable period, firms should be required to intervene with forbearance. Our broader concern, as outlined in response to question 5, that currently consumers in difficulties are not always being offered adequate forbearance is also relevant here. Without a strengthening of forbearance rules, many consumers in difficulty may not be treated with forbearance both when they cannot afford to enter a repayment arrangement or when they enter a repayment arrangement but find they are unlikely to repay the balance in a reasonable period.

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

Yes

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

We acknowledge that the persistent debt remedy is designed to work together with existing rules on forbearance. However, as outlined in our response to question 5 we have concerns about the existing forbearance rules. The consultation paper states (in footnote 39 on paragraph 55) that accounts in persistent debt were more likely to have missed multiple repayments, more likely to have experienced a CCJ and to go bankrupt than accounts that were not in persistent debt. This suggests firms have not consistently been applying CONC forbearance measures in these cases. We would again urge the FCA to consider whether the CONC rules on forbearance need to be strengthened.

We welcome proposals to remind firms that the new persistent debt rules should not reduce or remove the obligation on firms to take appropriate action where there are signs of actual or possible financial difficulties (CONC 7.3.4R).

## Earlier intervention

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

We agree that firms should be required to monitor other data in addition to a customer's repayment record for signs of actual/possible financial difficulties. We note that the consultation paper outlines that this data could include data on drawdowns, credit reference agency data and other product data held with the same firm. Nonetheless, the FCA does not propose any specificity in rules or guidance on what other types of data could be monitored. The question is if firms are able to identify what types of data they can monitor themselves then will the FCA be able to properly supervise whether firms are fulfilling the requirement to also monitor any relevant information other than a customer's repayment record. We would suggest some guidance may be necessary on what type of other data could be monitored (including the types of data outlined in the consultation paper). This would then enable the FCA in supervision to examine whether firms are adequately monitoring this data.

**Q13: Do you agree firms should be required to take appropriate action where there are signs of actual or possible financial difficulties?**

We agree that firms should be required to take appropriate action where there are signs of actual or possible financial difficulties. We also welcome that there will be guidance with examples of what may constitute appropriate action.

**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?**

We agree that CONC 1.3.1G outlines a range of indicators that a customer is in financial difficulties and that signs of whether one of the matters in CONC 1.3.1G occurring should be monitored and firms should intervene in these circumstances.

However, we would suggest that the trigger for early intervention should be broader than just stepping in when customers are at a significant risk of serious financial difficulties such as a consecutively defaulting or having to agree a debt management plan. It should also be about preventing customers from falling into persistent debt. As stated in response to question 11 above, accounts in persistent debt are more likely to get into financial difficulties such as missing repayments, getting a CCJ, or going bankrupt. However, the signs of actual or possible financial difficulties do not include where there is a significant risk of the customer getting into persistent debt. We would want to see another sign included that where consumers are in or on the way towards 'persistent debt' (as defined by the FCA), they are considered to be at risk of possible financial difficulties and treated accordingly. If persistent debt has been defined as those repaying more in interest and charges than in principal then we would suggest it would be important to monitor this and include it as a sign of actual or possible financial difficulties.

**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?**

We agree with the proposed examples in guidance in CONC on what may constitute appropriate action and welcome that further potential actions that firms may consider are to be added including considering suspending, reducing, waiving or cancelling any further interest or charges. Nonetheless we would again highlight our concerns that some firms are not always currently exercising forbearance for customers in financial difficulties. Therefore suggesting firms also consider forbearance through freezing or reducing interest/charges as an early intervention measure is important but must be properly supervised to ensure firms are doing this where appropriate.

We also note that the new rules will require firms to establish, implement and maintain an adequate policy for identifying and dealing with customers showing signs of actual or possible financial difficulties. This is also a welcome requirement but also raises the need for the FCA to ensure that these policies are adequate and ensuring early intervention action is actually preventing more consumers from getting into financial difficulties and persistent debt with their credit cards.