

StepChange Debt Charity response to FCA consultation paper CP18/12 – Rent to Own

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Introduction

StepChange Debt Charity is the largest specialist debt advice charity helping people across the UK, with 620,000 people contacting StepChange in 2017. We welcome the opportunity to respond to the Financial Conduct Authority's consultation on rent-to-own pricing. In 2015, StepChange supported the APPG on Debt & Personal Finance inquiry into the rent-to-own sector and in 2017 contributed to a report produced by the End Child Poverty coalition, *Feeling the Pinch: furnishing your home with rent-to-own*.

Question 1: [For discussion] What alternative solutions could there be to address harm from high prices?

The rent-to-own business model is fundamentally problematic: it is predicated on achieving a high yield from loans made to a small 'captive' market consisting of a high proportion of customers in vulnerable circumstances with limited access to credit. The majority of rent-to-own customers are female, have children, live in rented accommodation and have a low income, with many dependent on social security income.ⁱ Evidence provided by rent-to-own providers shows that the rent-to-own business model rests on offering services in locations with a large pool of potential consumers with low incomes but high creditworthiness for small, regular payments.ⁱⁱ

The costs that arise from lending to customers with a high risk of credit default require rent-to-own providers to cross-subsidise through an inflated pricing model. The issues the FCA has identified that cause detriment to consumers are structural and central to the present rent-to-own model. We note that there is ongoing change among the remaining rent-to-own providers following recent supervisory interventions linked to affordability assessments.

We agree that a price cap set at an appropriate level will achieve the FCA's aim of balancing avoiding indebtedness for people for whom a rent-to-own product is likely to reduce economic welfare and achieving continued access at reduced cost for people who are less at risk of harm and wish to continue to access rent-to-own products. Intervention is justified on the grounds that the present rent-to-own business model has an unacceptably high likelihood of causing detriment to consumers.

We do not see a realistic prospect of significant and meaningful change in the rent-to-own business model in the absence of regulatory intervention. A price cap will achieve the FCA's aim of protecting consumers who would have been better off had they not purchased a product through a rent-to-own agreement while protecting rent-to-own consumers from excessively high prices. We believe the FCA has clearly evidenced the harm caused to consumers by existing rent-to-own product structures and

has provided an analysis that justifies intervention through a price cap. We do not believe there are alternatives that will achieve the aims the FCA has set out.

This noted, we would like to see the FCA consider additional proposals. In particular, we welcome the role the FCA is playing in promoting financial inclusion and supporting the growth of affordable alternatives to high cost credit. The FCA should consider what opportunities there are to ensure potential rent-to-own customers have good information about alternative and more suitable options. The FCA has highlighted that many rent-to-own customers feel that they do not have alternative purchasing options. However, many people may be missing out on viable alternatives, including purchasing an item using a loan from a responsible credit provider, purchasing an item through a responsible rent-to-own provider (such as a third sector lender), or grants from a range of organisations. The FCA should explore opportunities such as requiring rent-to-own providers to make available material supplied by a local authority on local and national sources of affordable credit, help accessing essential household items and sources of financial advice. Providers could also be required to provide information on alternatives to people who are declined a credit agreement.

We would also like to see the FCA do more to facilitate wider solutions for people who have little choice but to resort to rent-to-own products. As the FCA has identified, the reach of alternative sources of credit is presently limited. Providing alternative options for those who cannot access credit is primarily a matter of social policy, not consumer credit. However, the FCA has an important role in making available and highlighting evidence from financial services that impact on social policy, particularly given its unique access to data and evidence. It is particularly important that policy makers understand how the credit market is segmented and what the constraints and limits are on affordable alternatives to 'subprime' high cost lending. We would welcome further work from the FCA on the capacity and potential of credit markets to meet social needs.

Question 2: [For discussion] What issues should we take into account in carrying out further work on a price-cap?

We have considered the potential impact of two broad price cap models:

1. Australian consumer lease model

In CP18/12, the FCA cites the proposed 'consumer lease' (rent-to-own) price cap put forward in the 2016 *Review of the small amount credit contract laws* and currently pending legislation with cross-party support.

The cap operates through an initial cap on the base price of a product which, depending on the circumstances, may be linked to RRP or 'market value', whichever is lower. For second-

hand goods, a simple depreciation model linked to an initial value linked to RRP or market value is proposed.

The cap on credit is equal to the initial base price plus 4% of the base price for each month of the lease term, up to 48 months. Over a typical three year (36 month) rent-to-own agreement, credit would be capped at 144%.

The cap is inclusive of insurance and any warranty but exclusive of delivery and installation costs. However, the latter must reflect market rates.

2. 'Nearest fit' application of the 100% price cap on HCSTC

While we agree that on a practical basis, as noted by the FCA in CP18/12, the cap on HCSTC cannot simply be extended to the rent-to-own sector, we do believe that it is possible to adapt the cap relatively simply. In this case, we assume that as in the consumer lease model, the base price of an item would be linked to RRP or reasonable market value. The maximum total cost of the item would be 100% of the base price, i.e., a £500 product cannot cost more than £1,000, whatever the loan term. This model would, however, exclude the 0.8% cap on interest and charges per day. As discussed below, it may be appropriate to combine a cap on the total price of rent-to-own credit with a monthly cap on credit interest (with the former operating as a backstop).

We note the practical approach embodied in the Australian consumer lease model and believe it demonstrates that the FCA should take a positive approach to tackling the potentially difficult problem of anchoring the base price of rent-to-own products. The key weakness of the consumer lease model is that it has the potential to be regressive by limiting costs for shorter-term, more affordable loans but having less impact on longer-duration loans. The FCA's evidence suggests that most rent-to-own agreements are over periods of more than one year and that it is over such long-term loans that excessively high cost accumulate. It is not clear that the consumer lease model would substantially address detriment to the majority of rent-to-own consumers.

We believe a 100% cap on the cost of rent-to-own credit is a reasonable starting point for a price cap: it would meet the aim of reducing detriment by preventing extremely high costs and also has the merit of having existing support and being simple and easy for consumers to understand. The effect of the cap would be likely to reshape rent-to-own lending towards a similar model to that adopted by responsible providers, with shorter loan terms and a greater emphasis on affordability. The cap would, however, leave open the possibility of relatively poor value loans over shorter periods. By reducing profits made on long-term loans, it could also, if not carefully designed, encourage compensatory price inflation in other elements of the rent-to-own product structure.

A further option would be to incorporate both a monthly interest rate cap and a backstop price cap into a price cap model. While more complex than a simple cap, this approach would promote the interests of customers who experience disproportionately high costs, whether over short- or long-term loan durations. It would also go some way to protecting customers who terminate loan agreements early and return items; this is particularly important given that the FCA cites evidence that only around half of rent-to-own agreements reach the point of ownership.

There are inevitable trade-offs in designing an effective price cap. We note that the planned Australian consumer lease cap is modelled on an existing cap on the cost of short term credit in Australia (with some adjustments). Given the importance of designing a price cap around widely shared principles in the UK, we would urge some caution in borrowing directly from this or other international models rooted in a specific context that may lack legitimacy in a UK context.

In designing a price cap, we believe the FCA should:

- Ensure that the base price of products is anchored at a reasonable market price. Responsible rent-to-own lenders are able to offer products at RRP, although rarely at discounted rates. We believe it is therefore reasonable to cap the price of products at RRP or an equivalent reasonable market rate where RRP is not available. In the latter case, this can be achieved by requiring providers to show how they have benchmarked market rates for an equivalent product. This process would, in turn, be monitored through FCA supervision. The FCA should now outline draft guidance that can be tested with consumer groups, providers and the public.
- Set out clearly how it has considered extending the 100% cap on the cost of credit to the rent-to-own sector and, if choosing not to recommend a cap modelled on this principle, explain clearly the reasons for not doing so. The price cap should protect consumers against high prices linked to long-term loan structures and we believe the 100% cap is the simplest way of doing so that will be widely understood and supported.
- Consider combining a monthly cap on interest rates with a backstop price cap of 100% of the cost of credit. This would protect people with shorter loan agreements from detriment from excessive costs. We would not, however, support a monthly cap without a backstop price cap as this approach is likely to fail to address the primary source of consumer detriment caused by rent-to-own products.
- Require that delivery and installation fees are set at a reasonable amount taking into account market rates. Where included in a loan (i.e., not paid up front) these fees should be included in the price cap.

- Limit missed payment or default fees to £15 for each year of the loan term, drawing on experience of implementing the cap on the price of high cost short term credit.
- Ensure that the implementation of a price cap does not lead to price inflation in other components of rent-to-own pricing by implementing effective regulation of the sale of warranties and insurance. We will respond in due course to the FCA's proposals to ban rent-to-own warranties at the point of sale but note that, as the cost of these add-ons can constitute a high proportion of rent-to-own payments, they must be considered as part of a coherent price cap. Interventions should seek to ensure that these add-ons are genuinely optional and, where taken up, represent a reasonable market price for the service provided.
- Commit to reviewing the price cap after an appropriate period and no later than within three years.

ⁱ *Report from the inquiry into the Rent to Own sector* (2015) APPG on Debt & Personal Finance; *Feeling the Pinch: Furnishing your home with rent-to-own* (2017) End Child Poverty.

ⁱⁱ Oral evidence, Treasury Committee inquiry into household finances: income, savings and debt, HC 565, 28 February 2018.