

StepChange Debt Charity response to FCA consultation paper CP18/42 – Overdrafts consultation paper and policy statement

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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 overdrafts.

Around half of StepChange clients (49.8%) have accumulated overdraft debt, of an average of £1,607, at the point they seek debt advice.¹ This compares to estimates that between a third and a half of PCA holders use an overdraft at least once a year with a typical overdraft credit utilisation of £250.² On average, clients with overdraft debt surveyed by StepChange had been in their arranged overdraft 11 out of the last 12 months.³ Almost two thirds of StepChange clients (62%) with overdraft debt have regularly had to exceed their arranged overdraft limit, doing so in an average of five out of the last 12 months.⁴

Through our research we have found a number of issues, including unaffordable authorised and unauthorised overdraft lending that can compound debt problems for people in financial difficulty, complex pricing structures that make it difficult for consumers to understand and manage their overdraft use, and a failure by firms to use signs of financial difficulty to intervene and support customers to avoid repeat and persistent overdraft use and provide forbearance where appropriate.⁵

We therefore welcome the FCA's proposals to align authorised and unauthorised overdraft fees using a simple interest rate structure and require firms to implement effective strategies to identify and address repeat overdraft use, which we believe will make a substantial impact on these problems. In this consultation response, we have set out how we believe the FCA's proposals can be implemented most effectively.

Q1: Do you agree with our proposal to align the charges for arranged and unarranged overdrafts?

We agree with the proposals to align the charges for arranged and unarranged overdrafts. We believe the FCA's proposals to require firms to align charges for arranged and unarranged overdraft fees will allow firms to continue offering overdraft products while better protecting the most vulnerable consumers against unfair and harmful charging practices that cause and exacerbate financial difficulty. Through its high cost credit review, the FCA has demonstrated that the impact of high unarranged fees falls disproportionately on vulnerable groups. As a debt advice provider, StepChange has seen directly widespread evidence of the harm high overdraft fees do to people in, or at risk of, financial difficulty. We set out this evidence in our response to CP18/13, including the high proportion of people in problem debt who have accumulated an unsustainable overdraft debt and paid regular repeat authorised and unauthorised fees. Authorised overdraft fees (including

¹ StepChange Debt Charity (2018) *Statistics Yearbook 2017*

² GfK NOP (2015) *Personal current account investigation: A report for the Competition and Markets Authority*; Financial Conduct Authority (2018) *High-cost Credit Review: Overdrafts Consultation Paper CP18/13*

³ StepChange Debt Charity (2016) *Falling into the red: How overdrafts can lead to problem debt*

⁴ StepChange Debt Charity (2016)

⁵ StepChange (2017) *Stuck in the red: StepChange Debt Charity client stories of persistent overdraft debt*.

interest charges and additional fees) make a significant contribution to financial difficulties, particularly for those with low incomes for whom modest monthly fees can be larger than any disposable income. However, unauthorised overdraft fees are the greatest driver of high overdraft debt among our clients. The FCA's proposals are likely to significantly reduce levels of overdraft debt among those in financial difficulty. We also expect that this will have positive secondary effects on their ability to manage wider debt problems.

Q2: Do you agree with our analysis that our rules on alignment should not allow firms to charge more for unarranged overdraft use (no uplift)? If you disagree with our analysis, please provide evidence outlining the additional costs an uplift is required to cover and the level of uplift required.

We agree with the FCA's proposed rules that do not allow an 'uplift' for unarranged overdraft fees. The FCA's evidence supports the conclusion that such an uplift does not have a basis in firms' costs. It would also have negative side-effects: an uplift would add complexity to the simplified overdraft fee model that would reduce transparency for consumers and undermine the FCA's competition aims. It would also undermine the proposed repeat use rules: use of an unauthorised overdraft can be a strong indication of financial difficulty and an uplift would act as a tacit acceptance that regular use is a product feature rather than a pattern to be avoided so far as possible. Finally, we note that where banks have chosen to reform overdraft charges and end unauthorised overdraft fees, they have not felt it necessary to provide for an uplift of this type.

Q3: Do you agree with our proposal that charges for unarranged overdrafts should be unenforceable if their level exceeds the level of arranged charges?

We agree that charges for unarranged overdrafts should be unenforceable if their level exceeds the level of arranged overdrafts. There appears to be the potential for complex situations in which it is unlikely to be obvious to consumers that they are entitled to a refund, for example arising from complex usage patterns and the separation of overdraft debt as part of a debt solution. The FCA should require firms to refund unenforceable overdraft fees on an automatic basis so far as possible.

The FCA's position that unarranged overdraft fees are unacceptably high and are concentrated on a minority of vulnerable consumers raises a question as to why no retrospective redress package is planned. The FCA's analysis forms clear evidence of cases where firm should reasonably have treated customers showing signs of financial difficulty differently and therefore not made further overdraft charges that compounded that difficulty. Instead, people who have repeatedly exceeded the overdraft limit while in financial hardship have been charged excessive fees rather than treated fairly. We note particularly section 9 of the Lending Code and section 5.1.4 of the Banking Conduct of Business Sourcebook ('in particular, a firm should deal fairly with a banking customer whom it has reason to believe is in financial difficulty'). The FCA's proposed repeat use rules are a direct

response to firms' failure to adequately respond to customer's circumstances, some examples of which are outlined in paragraph 5.5 of CP18/42. These examples, which include a lack of early intervention, firms relying on customers to resolve difficulties themselves and ineffective communications, are evidence of a pattern of failure to meet agreed standards. We note that a minority of firms have already removed unauthorised overdraft fees from their current accounts due to concerns about the distribution and impact of these fees. The FCA should now use its powers to establish and operate a consumer redress scheme to address historic failures in firms' overdraft charging practices.

Q4: Do you agree that firms should be required to charge for overdraft by a single interest rate?

We agreed with the FCA's proposals to require firms to charge for an overdraft using a single interest rate in our response to CP18/13. We agree with the FCA's analysis that overdraft charges should be simple, easy to understand and easily comparable, and free of cliff-edges that distribute costs unevenly regardless of the amount borrowed and to the potential harm of consumers. We do not see that the FCA's proposals are likely to unduly stifle any plausibly beneficial innovation.

This noted, we have reservations about the FCA's proposal to allow firms to charge varying interest rates for overdrafts on a risk-based per customer basis. In addition to the potential to increase fees for some users, this decision could somewhat undermine the competition element of the package of measures. The FCA has sought to facilitate increased account switching by making it easier to obtain a quote for a new account and compare fees. The reality, however, remains of substantial customer inertia that may undermine fee competition. We agree that the requirement to express overdraft charges in a single interest rate per account should foster competition. A varying interest rate expressed in APR is not unusual for credit products, but overdrafts do not operate like a typical loan (with varying periods and levels of borrowing). It is less transparent than a fixed interest rate, will make it harder for consumers to understand exactly what they will be charged and may reduce the likelihood that customers will consider switching accounts. This in turn could undermine the extent to which the new fee structure lowers fees through competition that benefits consumers.

While we broadly support the FCA's proposals, we believe that there remains a case for a cap on overdraft charges and are glad the FCA notes that it will keep the case for a cap under review. Despite the benefits of the FCA's package of measures, a cap has substantial additional benefits with limited downsides for consumers. In addition to the benefits for transparency and competition, we would like to highlight three issues in particular:

- Moving to a single interest rate for overdraft charges is likely to lead to increased risk-based pricing. While we agree that the most financially vulnerable overdraft users will benefit significantly through the package of measures the FCA proposes to implement, it is probable some heavy overdraft users in financial difficulties or with low incomes who are adjudged to be a greater credit risk will see the cost of using an overdraft increase. One bank that has abolished unauthorised fees nevertheless implemented a fee structure for authorised fees

that imposed higher fees on users with higher outstanding balances, which suggests other may seek to replicate this approach within the parameters of the new rules. We note, of course, the role the repeat use rules (and existing rules governing customers in financial difficulty) in limiting such repeat costs when people are in difficulty. However, there are many customers with low incomes who are not in acute difficulty who could be negatively affected because their borrowing costs rise as a result of standard approaches to risk-based pricing. While we would expect the FCA's measures to significantly reduce overdraft costs for those in most difficulty who have routinely paid unauthorised overdraft fees, it will not end the experience of an 'overdraft trap' for many people with low incomes during periods of financial difficulty.

- The FCA does not appear to have addressed the potential for re-pricing of overdraft fees over time. The FCA's proposals may cause firms to move to standard overdraft charging practices similar to those for revolving credit, where firms may re-price interest in response to their own costs or changes in a customer's circumstances. Firms are, however, required to provide 30 days' notice and allow customers a grace period of 60 days to repay the principal at the original interest rate. Re-pricing of overdraft fees could lead to a new form of 'back door' charging similar to unauthorised fees, where banks raise fees in response to indications of credit risk such as a higher outstanding overdraft balance. We would welcome clarification from the FCA about what forms of re-pricing will be allowable and how it will ensure customers are treated fairly and customers in financial difficulty are not targeted with higher fees.
- The maximum monthly charge (MMC) was designed to address concerns about cumulative overdraft charges, a lack of transparency and the need to protect heavy overdraft users.⁶ Both the CMA and the FCA have been explicit about related practices linked to unauthorised fees that are unacceptable. The MMC will presumably still be in place following the implementation of the requirement on firms to align arranged and unarranged overdraft fees. Logically, this means the MMC should either be removed because it is no longer required, or revised and re-designed in the light of the changed context to reinforce the framework of practice the FCA now expects. We suggest that, at a minimum, the MMC should be extended to authorised overdrafts to meet the original aims of the CMA intervention, since the MMC will no longer function as intended if limited to unauthorised fees (since unauthorised fees will be so reduced the context in which additional charges are applied will be radically different)

We remain of the view that the FCA should itself set a market-wide cap on overdraft interest rates rather than rely on voluntary limits, which appear to have been relatively ineffective in a concentrated PCA market with high consumer inertia. We note the FCA's recent decision to implement a cap on the cost of rent-to-own products on the basis that a minority of vulnerable consumers are paying too

⁶ Competition and Market Authority (2016) *Retail banking market investigation: Provisional decision on remedies*.

high a price for goods (set out in CP18/35 and PS19/6). The FCA has set out similar evidence in relation to unauthorised overdrafts in CP18/13 and CP18/42. We expect the FCA's proposals to address excessive overdraft costs but believe there is some potential in the long-term for fee models to evolve in a manner that leads to excessively high charges that are concentrated on vulnerable consumers.

We welcome the FCA's commitment to evaluate the impact of the proposals after 12 months: this should include further robust distributional analysis of the effect of the changes on overdraft costs for customers who are financially vulnerable, whether or not they are considered to be in financial difficulty. Using this evidence, the FCA should review the case for setting a monthly overdraft price cap itself, taking into account the extent to which some customers face high cumulative charges, including from repeat refused payment fees. Taking into account analysis of the range and distribution of interest rates charged by firms, and its impact on competition, the FCA should also consider the case for limiting the single overdraft interest rate to a single per account rate.

Overdrafts are designed for short-term lending and it should not be possible for fees to accumulate over a long period through repeat fees. None of the FCA's proposed price interventions fully address this problem, and nor would a monthly fee cap (since fees might still accumulate over a longer period). We also consider it likely the proposed repeat use rules may not prevent inappropriate long-term use because they do not include any 'hard' trigger thresholds for forbearance (nor will the rules require action beyond information, advice and signposting for people not identified as being in difficulty). We see two ways for the FCA to address this problem: one is to implement a running overdraft total cost cap – this is feasible but appears technically difficult. Another simpler option that would have a similar effect would be to introduce minimum trigger thresholds for forbearance in the repeat use rules, such as (but not limited to) three months of consecutive overdraft use. This would act as a 'soft' total cost cap targeted at those for whom overdraft charging has become inappropriate.

Q5: Do you agree that we should require firms to disclose the representative APR in advertising where the representative example or representative APR is triggered?

Yes, as noted, we agree that simplifying overdraft fees will help consumers to better compare overdraft costs and agree with the FCA's analysis that using a single interest rate expressed in APR is likely to be the most effective way of doing so. We also agree that requiring the representative APR and an example using a standard form of wording ('How does your overdraft compare?') to be prominently and clearly displayed will help consumers to understand and compare overdrafts as a debt product when making decisions about acquiring or switching accounts.

Q6: Do you agree with our proposed guidance to help firms to calculate APR consistently?

We agree that the guidance should be provided and have no comment on the proposed wording.

Q7: Do you agree that in addition to existing rules in CONC regarding the disclosure and prominence of the representative example and representative APR, we should require firms to include the title 'how does our overdraft compare' and explain that representative APR can help consumers compare the overdraft?

We agree with the specific additional requirements proposed by the FCA. This language is simple and should ensure price information given in standard product literature and marketing is easy to understand and compare. We do not consider the requirement or language will unduly constrain or limit firms' flexibility to tailor promotions.

Q8: Do you agree that firms should report to the FCA information about their representative APR and that we should publish this information?

We agree that firms should regularly report the APRs used in financial promotions and that the FCA should publish this information to support transparency. While we would expect consumers to make direct comparisons and use comparison sites as at present, by publishing this information the FCA can support its own understanding of the market and consumers' experiences and support external analysis by a range of public, media, political and academic stakeholders. (We would also be interested to know if the Bank of England will now add overdraft interest rates to its suite of statistics, though this is not a matter for the FCA.) This noted, we believe it is most important that the FCA analyses and publishes clear information on the distributional impact of overdraft fees, including the true range of fees actually paid by consumers taking into account risk-based pricing.

Q9: Do you agree that it would be helpful for firms to give consumers a clear example showing what an overdraft might cost in pounds and pence if they borrowed money for a period of a day, a week, a month or a year?

We agree it would be helpful for firms to provide a clear example in a standard format showing what an overdraft will cost in pounds and pence over a day, week, month and year. We agree with the FCA's conclusion that consumers are more likely to be able to choose the most affordable overdraft if costs are expressed in APR but that most consumers are not able to use APR to calculate specific costs. Patterns of overdraft use are variable and there is no perfect solution to provide transparency for consumers. We support the FCA's approach of providing a range of ways for consumers to understand and calculate overdraft costs including a standard 'pounds and pence' industry disclosure box and an online calculator.

Q10: Do you agree with our proposals for guidance for recovering costs via refused payment fees? If you disagree, please set out which costs should be excluded and why, and which costs should be included and why.

We agree that there is some risk firms could seek to recover income from unarranged fees through higher refused payment fees and support the FCA's proposed guidance requiring that fees must reasonably reflect relevant costs. Refused payment fees are most likely to affect more vulnerable consumers we know to be at greater risk of repeat or persistent overdraft debt. This issue is not only about the level of each refused payment fee but the cumulative impact of repeat fees. We note that refused payment fees fall within the MMC for unarranged overdraft fees. The MMC was designed on the basis that it would cover the range of unarranged overdraft fees. The FCA's proposals will now substantively change the context in which the MMC was designed in that unarranged fees will in most circumstances be dramatically reduced. This could allow more headroom for repeat refused payment fees to accumulate for some consumers. In evaluating the impact of its policy, the FCA should examine not only whether refused payment fees reflect reasonable and relevant costs, but whether repeat fees contribute to a greater extent to costs for people in financial difficulty and/or contribute to those financial difficulties or otherwise cause hardship. We would consider that an increase in the frequency of repeat fees, particularly for those who are most vulnerable, because firms apply them in new ways in response to the alignment of arranged and unarranged fees would support the case for the FCA to impose a monthly overdraft price cap.

Q11: Do you agree with our proposed application of the rules?

We agree with the proposed application of the rules to PCAs and have no comment on the application of the rules to business accounts.

Q12: Do you agree that firms should be given 6 months to comply with the proposed rules?

We agree with the FCA's proposed implementation timetable. Given the harm identified by the FCA linked to overdraft fees, and the concentration of this harm on vulnerable people, it is imperative that the new rules are implemented as soon as possible.

Q13: Do you have comments, observations or evidence on whether overdrafts provided to micro-business customers or products marketed to consumers as having the same function as an overdraft should be subject to similar rules to those proposed in this CP?

N/A.

Q14: Do you agree with our final proposals for addressing the harm from repeat use of overdrafts?

We welcome the FCA's proposed rules, which are likely to reduce overdraft costs for people affected by problem debt and provide earlier advice and support to manage and address financial problems. This noted, we believe aspects of the proposals could be improved:

- We recognise that the FCA has deliberately chosen not to specify a precise definition of repeat overdraft use, in part in light of the variety and complexity of situations where repeat use might be identified. However, we are concerned that the proposed rules do not strike fully the right balance between specificity and flexibility. We are particularly concerned that the rules will create a bias towards late stage intervention where repeat use is anchored to use over nine or more months a year. We do not consider this acceptable since by this stage financial problems may be at an advanced stage.

We would like the FCA to provide rules and guidance specifying the type of situations, at a minimum, that should be considered fall within the definition of repeat use. This should make clear that the purpose of the rules is to identify early repeat use. Potential indicators that should require banks to check for signs of financial difficulty include consecutive months of use (we would suggest three months as an initial threshold, reflecting the core short-term purpose of overdrafts), recurrent instances of overdraft use over a fixed period (such as three months out of any six month period) and cumulative use (such as 90 days of use in any 180 day period). In each case, use would need to suggest dependence, i.e. the lowest negative balance over consecutive periods would need to be increasing or of a similar level.

We do not underestimate the technical difficulty of choosing an appropriate set of triggers and the right approach would need to reflect careful analysis of the patterns of overdraft use associated with financial difficulty. This would not undermine the range of situations the FCA has sought to highlight in its guidance, since these could also be encompassed by the guidance, but would act as a minimum threshold and support early- rather than late-stage engagement with customers potentially in financial difficulty. The risk of 'false positives' is a reality of early intervention work that must not be allowed to detract from the significant benefits of early intervention for vulnerable consumers, not least because through sensitive communications very few people not in financial difficulty are likely to be negatively affected if 'wrongly' contacted as a result of the repeat use rules. Without such clarifications it appears extremely unlikely the rules will support early- rather than late-stage intervention.

A useful further step would be for the FCA to publish examples that illustrate its expectations of firms. These need not be exhaustive, which would preserve firms'

flexibility to implement the rules taking into account the characteristics of their overdraft products and customers. We would also welcome clarity about how the FCA will work through its evaluative work and using submissions from banks to develop the rules in future, for example if commonalities emerge in the most effective practice among banks.

- We are concerned that it will not be possible for consumers or other stakeholders to gain a clear and transparent understanding of firms' repeat use policies. This will mean consumers could have no information or framework for understanding in what circumstances a bank would intervene, save the information provided if they are directly affected. This does not appear reasonable since each firm's repeat use policy will effectively form part of the terms agreed to when holding an account with a firm. A lack of transparency could also hamper debt advice providers who need clear information about how an overdraft will be managed to advise clients.

To address this issue, we would like the FCA to require firms to publish a statement explaining their repeat use policy that is available to consumers and other stakeholders. This statement should explain the framework that firms will use to identify when customers are struggling or an overdraft is no longer an appropriate borrowing product, how firms will work with customers in these circumstances and what actions they will take. This will provide clarity for consumers, particularly for those who are in difficulty, about what they can expect. This requirement would also help to ensure firms join up the way that their overdraft product is designed and marketed with the repeat use rules.

- We welcome the FCA's proposed requirement for firms to report on outcomes after 6 and 12 months. However, we do not believe it would be appropriate for the FCA to measure success in reducing repeat overdraft use by people in financial difficulty using metrics chosen by firms. The FCA should establish an independent framework for assessing the success of its intervention using specific measures. We suggest these should include the type of trigger threshold noted above but would welcome further work from the FCA to develop suitable measures.

In general, the repeat use rules risk repeating flaws of the persistent credit card debt rules. These rules are too loose and have allowed firms to respond to persistent debt with blunt increases in minimum or 'recommended' payments rather than with an offer of help and support for customers. We have seen little evidence of widespread engagement as a result of the rules from those who are in or at risk of financial difficulty. This reflects in great part firm behaviour but also the fact that, in the absence of clear requirements to waive charges where the persistent threshold is breached, there is no clear message or offer to reduce the debt in a safe way for consumers who are in difficulty. The repeat overdraft use rules are even more vague, with no clear definition of repeat use and no clear requirements on firms to intervene except for those in the clearest financial difficulty. Even for those identified to be in difficulty, there is no clear organising principle to guide how firms respond. It is likely that firms will respond in a similar manner to credit card providers by tweaking product

structures the minimum amount necessary to meet the rules. For overdrafts, this may mean 'stepping down' an overdraft each month but continuing to apply charges. This may not be a sufficient response for those in financial difficulty for whom overdrafts have become an unsuitable form of borrowing. The FCA can address this issue by clarifying the minimum trigger circumstances in which repeat use must be identified and providing a clear framework of support and forbearance for firms once repeat use has been identified. This framework should be organised around the principle that overdrafts are a short-term form of borrowing and the onus is on firms to provide a safe way out and waive costs for consumers in difficulty once this is no longer the case.

As a free debt advice provider, StepChange has developed its service to respond to people who have been signposted to free debt advice by lenders under the FCA's persistent credit card debt rules (initially at the 18-month threshold). The proposed repeat use overdraft rules create a similar requirement for firms to refer customers who are repeat overdraft users and in financial difficulty to free debt advice. The outcomes for people in persistent debt who have contacted StepChange are sufficiently positive that we welcome this step. We have found that people affected who do contact debt advice are often seeking advice and help at an earlier stage than they would otherwise have done, and that a majority of people who are referred are suitable for either the budget advice or full debt advice process. However, elements of the requirement in the persistent credit card debt rules to refer to free debt advice are working less well. This includes:

- The numbers of contacts we receive suggests that most people contacted as a result of the persistent credit card debt rules are not responding to signposting to free debt advice.
- This trend may be linked to the lack of a clear offer that is relevant to those who are referred – it would for example, be helpful if people understood precisely what benefits a free debt advice provider can provide (which includes general advice and explanations about persistent debt and help making a budget and making a repayment plan for outstanding debt as well as conventional debt advice). At present, people may be discouraged because they do not think they need advice (or are reluctant to seek it) and only learn of support that may be relevant to them if they reach a free debt advice provider.
- Poor or inconsistent messaging by firms is creating confusion among customers. This is sometimes linked to specific actions firms take, such as increasing minimum payments. People in financial difficulty may also receive communications that do not explain clearly that if they cannot afford to increase minimum payments the firm must offer forbearance, which results in stress and for some a failure to engage because they do not believe they can meet the proposed actions a firm has set out. We are particularly concerned that communications and interaction with customers must be sensitive in order not to drive people to take decisions that exacerbate their financial problems, such as delaying seeking advice or taking on more debt for fear of losing access to an overdraft.

In the light of these issues and the extension of rules requiring referral to free debt advice providers through persistent debt rules for catalogue credit and store cards, and repeat overdraft use, we would welcome further work from the FCA to support a more coherent approach among firms. StepChange continues to proactively engage with firms and industry bodies to encourage well-designed engagement and communication. However, the problems we see are difficult to resolve fully this way: firms are reluctant to share what they consider to be commercially sensitive information and capacity constraints prevent detailed discussions with a large and growing number of firms affected by the persistent debt and repeat use rules. It is not clear to us that trade organisations are any better placed to develop and encourage consistent good practice since they do not represent consumers and face some of the same obstacles in coordinating among competing firms reluctant to share information.

The FCA could help improve practice by:

- Collecting information from firms about their persistent debt and repeat use policies on an anonymous basis, or alternatively requiring a minimum level of transparency from firms.
- Coordinating a steering group of firms and free debt advice providers with a remit to develop good practice guidance.

We are concerned that these issues are likely to persist and undermine the effectiveness of the persistent credit card debt and repeat overdraft use rules if the FCA does not closely monitor and respond to the situation. We welcome further dialogue on this point and are happy to share early learning from StepChange's persistent debt service to ensure that support for people affected by the repeat overdraft rules work as well as possible.

Q15: Do you agree with the changes proposed in this chapter? (Chapter 8)

We agree that the FCA should bring forward the implementation date for the rules linked to overdraft alerts and information so that implementation is aligned with the rules simplifying overdraft pricing. It is imperative that the new pricing rules are implemented as fast as possible to protect vulnerable consumers and, as the alerts and information rules effectively function as a package with the pricing intervention, we agree it makes sense to align implementation dates.

Q16: Do you agree with our cost-benefit analysis?

N/A