

FINANCIAL CONDUCT AUTHORITY (FCA) INVITATION TO COMMENT: HIGH-COST CREDIT REVIEW: OVERDRAFTS CONSULTATION PAPER AND POLICY STATEMENT (CP18/42)

FEBRUARY 2019

1. INTRODUCTION

- 1.1. Fair By Design welcomes the Financial Conduct Authority's invitation to comment on the Overdrafts Consultation Paper and policy statement (CP18/42).
- 1.2. Please note that we consent to public disclosure of this response.
- 1.3. For more invitation about this response please contact Lucie Russell, l.russell@barrowcadbury.org.uk Tel: 020 7632 9070.

2. ABOUT FAIR BY DESIGN

- 2.1. Fair by Design is a movement dedicated to reshaping essential services, like energy, finance and insurance, so they don't cost more if you're poor.
- 2.2. People in poverty pay more for a range of products including expensive energy tariffs for pre-payment meters, high cost loans, rent to own products such as kitchen appliances, and insurance in poorer postcodes. This is known as the Poverty Premium.
- 2.3. We collaborate with industry, government, and regulators to design out the Poverty Premium, and raise awareness amongst the public to bring about change.
- 2.4. Our venture fund provides capital to help grow new and scalable ventures to innovate the market.
- 2.5. Fair by Design was conceived by the Joseph Rowntree Foundation and Big Society Capital and is being led by the Barrow Cadbury Trust. The fund is managed by Ascension Ventures.

RESPONSE TO FCA INVITATION TO COMMENT: HIGH-COST CREDIT REVIEW: OVERDRAFTS CONSULTATION PAPER AND POLICY STATEMENT (CP18/42)

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

- 1.1. There appears to be little evidence to suggest the processing of unarranged overdrafts costs firms significantly more than processing an arranged overdraft.
- 1.2. We therefore agree with the FCA's proposal to align the charges for arranged and unarranged overdrafts.
- 1.3. We also urge the FCA to investigate ensuring that these new rules does not mean people using authorised overdrafts start paying more.

2. Do you agree with our analysis that our rules on alignment should not allow firms to charge more for unarranged overdraft use (no uplift)?

- 2.1. We agree with the FCA's analysis that vulnerable consumers are disproportionately harmed by high fees for unarranged overdrafts, and the cumulative charges for repeated use.
- 2.2. This is the Poverty Premium: the extra costs of being poor, and it is both a driver of, and driven by poverty.
- 2.3. Clients of the Money Advice Trust said that bank charges often sent them over their monthly budget limits, meaning that direct debits and standing orders could not be paid. This had a knock on effect for the following month, setting up a vicious cycle whereby people felt they were pushed further into debt which they were unable to get out of as they were unable to clear the overdraft.¹
- 2.4. The new world of work, while on the one hand beneficial for those that want more flexibility around their lives outside of work, comes with new risks that have the potential to impact people's finances.
- 2.5. In 2005 just 100,000 people worked a zero-hours contract². Today the figure is around 1.8m – which went up by 100,000 in just one year³. Not having guaranteed hours can have detrimental impacts on people budgeting and paying regularly bills and expenses.
- 2.6. A similar change in the world of work has been the rise in the number of self-employed workers. The number of self-employed increased from 3.3 million people (12.0% of the labour force) in 2001 to 4.8 million (15.1% of the labour force) in 2017⁴. The same figures by the ONS show that 72% of people on a zero hours contract express a preference that they didn't want more hours, or 63% of everyone on the contracts

¹

<http://www.moneyadvicetrust.org/SiteCollectionDocuments/Policy%20consultation%20responses/Unilateral%20responses/Money%20Advice%20Trust%20response%20to%20the%20FCA%20High-cost%20credit%20review%20Overdrafts%20consultation%20paper.pdf>

² <https://www.theguardian.com/business/2016/mar/09/zero-hour-contract-is-not-flexibility-but-exploitation-and-its-rising>

³ <https://www.theguardian.com/uk-news/2018/apr/23/number-of-zero-hours-contracts-in-uk-rose-by-100000-in-2017-ons>

⁴

<https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/articles/trendsinselfemploymentintheuk/2018-02-07>

(including the unknowns). This shows a not insignificant number of people that would desire more hours than they are currently working.

- 2.7.** Research has found many problems in late payment for people that are freelance or self-employed. According to the Federation of Small Businesses, 58% of their members are owed up to £10,000 in late payments from their clients. 15% are owed between £10,000 and £20,000, and an incredible 27% are owed over £20,000 from their late paying clients⁵.
- 2.8.** The Association of Independent Professionals and the Self-Employed (IPSE) research has shown freelancers spend an average of 20 days a year chasing late payments, with 43 per cent doing work they were not paid for at some point in their career. Freelancers have been found to lose a staggering £5,400 a year on average⁶.
- 2.9.** Participants in our research⁷ felt that:
- “[The] issue with savings/current accounts [is that] interest rates [are] really low but you go overdrawn, then high interest rates. [Banks] charge me a higher interest rate for my debts than [they] give for my money!”
 - “Some bank loans are much cheaper than overdrafts”
- 2.10.** On the last point, research has found that charges have previously resulted in overdrafts becoming more expensive than taking out a payday loan.⁸
- 2.11.** For overdrafts that are arranged, one participant also felt that
- “My bank charges are so unfair because bigger the overdraft, the bigger the fees.”
- 2.12.** As the FCA has noted, this is particularly problematic when customers go over a cost-free buffer by a small amount.
- 2.13.** We therefore agree with the FCA’s proposal to not allow firms to charge more for unarranged overdraft use.

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

- 3.1.** Ensuring that charges for unarranged overdrafts do not exceed those of arranged overdrafts, acts as an effective cap on the cost of unarranged overdrafts.
- 3.2.** We therefore agree with the FCA’s proposal that charges for unarranged overdraft use should be unenforceable if their level exceeds the level of arranged charges.
- 3.3.** In the future it therefore may be necessary for the FCA to impose an actual cap on the cost of overdrafts, arranged or unarranged, if the charges paid by consumers remain high despite a single rate of an interest across all overdraft borrowing.

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

⁵ <https://www.freelanceuk.com/news/16521-new-research-highlights-risk-late-payment-freelancers-region.shtml>

⁶ <https://www.politicshome.com/news/uk/economy/press-release/ipse/101952/ipse-late-payment-%E2%80%9Cscourge-self-employed%E2%80%9D-across-uk>

⁷ Focus group of 5 people self-identifying as on a low income, conducted in partnership with Fair By Design and Gingerbread

⁸ <https://press.which.co.uk/whichpressreleases/overdraft-charges-more-expensive-than-payday-loans/>

- 4.1. A single interest rate would ensure that the cost of borrowing was proportionate to the amount borrowed and would prevent consumers being penalised for borrowing small amounts over a charge-free limit.
- 4.2. Additionally, with fixed fees, there can often be a tunnel vision effect whereby consumers consider the cost of an overdraft on a daily basis, not realising the higher costs in the longer term – as seen in the rent-to-own market.
- 4.3. The lack of awareness around long term use is arguably evidenced by 20% of consumers not knowing how much they paid for their overdraft facilities in a given year.⁹
- 4.4. We therefore agree that firms should be required to charge for overdraft by a single interest rate.

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

- 5.1. Disclosing the representative APR in advertising may help in the reframing of an overdraft as a debt akin to loans or credit cards.
- 5.2. Additionally, consumers' awareness of what they are paying for their overdraft, or how this has been calculated, has been limited, often because of a lack of clear information.¹⁰
- 5.3. A participant believed that:
 - “Bank accounts use features like welcome bonuses to lure you in but don't provide clarity on extra fees and overdrafts”
- 5.4. However, we also 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, week, a month or a year. This is discussed further under question 9.

6. Do you agree with our proposed guidance to help firms to calculate APR consistently?

6.1. N/a

7. Do you agree that in addition to existing rules in CONC regarding the disclosure and prominence of the 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?

- 7.1. We feel that the inclusion of the title 'how does our overdraft compare' will not necessarily encourage consumers to compare the cost of an overdraft versus other forms of credit such as a credit card or loan.
- 7.2. Research has found that consumers perceive overdrafts to be a safer and more trusted option than loans or credit cards.¹¹
- 7.3. Additionally, although overdrafts were considered as a safety net and even a helping hand or perk from the bank¹², we know from previous research, namely by the CMA,

⁹ https://creditspring.co.uk/documents/financial_resilience_in_the_uk_2017.pdf

¹⁰ <https://www.fca.org.uk/publication/research/consumer-research-on-overdrafts.pdf>

¹¹ Ibid

that rates of switching personal current accounts are low. So personal switching should not be the only solution available to properly engage with this issue.

7.4. However, we do not feel that standardisation in the rules is disproportionate. Per our response to question 14, we are generally in favour of industry-wide initiatives.

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

8.1. We agree that firms should report to the FCA information about their representative APR. We would be interested in investigating how the information can be used in a way that the public can engage with, including on comparison websites and a central website run by a regulator like the FCA or CMA.

9. 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?

9.1. When asked if they would feel confident that they could calculate how much an overdraft would cost if given the rate of interest that would be charged, all participants in our focus group responded negatively.

9.2. On some ways that could help them to understand the costs of an overdraft, a participant felt that there was a need for

- “Simple language; numbers not percentages; the financial cost, not the percentage. This helps with your budgeting much more than a percentage.”

9.3. There was also support for an online calculator from one consumer who felt that it was

- “So hard to work percentages and fractions.”

9.4. A participant also queried

- “Why don’t they just tell you the cost [of the overdraft], why don’t [they] just tell me? I don’t have the headspace.”

9.5. Another raised issues of accessibility:

- “What use is [an] online calculator if [you are] not online?”

9.6. We therefore agree that firms should give a clear example showing what an overdraft might cost in pounds and pence.

9.7. The FCA could be prescriptive in ensuring this information is available across all mediums and not just online, for example.

10. Do you agree with our proposals for guidance for recovering costs via refused payment fees?

10.1. We agree that refused payments fees should reasonably correspond to the actual cost of refusing payments, and should exclude the costs of operating and maintaining a personal current account.

10.2. We support the FCA’s view that more clarity is needed from firms in the evidence they provide.

¹² <https://www.fca.org.uk/publication/research/consumer-research-on-overdrafts.pdf>

11. Do you agree with our proposed application of the rules?

11.1.

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

12.1. We agree that firms need a period of time to comply with the proposed rules.

13. 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?

13.1. N/a

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

14.1. While firms should develop individual strategies, we feel that there should be an industry approach towards early intervention and for addressing repeat use.

14.2. For instance, one participant suggested

- “Banks should have a duty to provide debt advice. Why leave it to charities?”

14.3. In the view of Fair By Design, banks having a duty to provide debt advice should not be a replacement for statutory debt advice delivered by voluntary sector organisations. Rather, banks should improve the routes to advice for people that find themselves in poor financial situations – including improvements to signposting and warm introductions to debt advice services. An increase in funding from banks towards providing debt advice would be a very welcome move, but this issue falls outside the scope of this response.

14.4. The emphasis on the importance of debt advice concurs with feedback already received by the FCA which saw a role for more signposting.

14.5. On what a bank could do to help a customer to avoid going into their overdraft, or incurring charges, participants suggested:

- “Reminder of loans and cheap services.”
- “Text messages [to warn of the] danger of going into unplanned overdrafts.”

14.6. On options for reducing use i.e. if someone is found to use their overdraft regularly, or not be paying it off in full, participants suggested:

- “They should freeze your interest so you can get out of it.”
- “[Stop] upping credit limits without informing you, or a request being made by you.”

14.7. We are generally supportive of greater prescription and guidance within the rules. These suggestions could all form part of an industry-wide approach to reducing the harm caused by repeat use of overdrafts.

15. Do you agree with the changes proposed in this chapter? (Chapter 8)?

15.1. N/a

16. Do you agree with our cost-benefit analysis?

16.1. N/a