

Consultation response

High-Cost Credit Review: Overdrafts consultation paper and policy statement (FCA CP18/9)

Response from the Single Financial Guidance Body

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1. About us

1.1. The Single Financial Guidance Body (SFGB) helps people make the most of their money and pensions. It brings together the services of the Money Advice Service, The Pensions Advisory Service and Pension Wise, under one body.

1.2. We deliver this across five core functions:

- Pensions guidance
- Money guidance
- Debt advice
- Consumer protection
- Strategy (working with the financial services industry, devolved authorities and the public and voluntary sectors to develop and coordinate a national strategy to improve people's financial capability)

1.3. We have a duty to ensure that information, guidance and advice is available to those in greatest need of it, including people in vulnerable circumstances.

2. Summary of response

2.1. We support regulatory changes that reduce the cost of overdrafts for consumers, especially the most vulnerable, and promote better use of this product. However, we believe there are potential unintended consequences the Financial Conduct Authority (FCA) could consider in more detail when proceeding with its proposals.

- Whether higher arranged overdraft prices (as predicted) will have a disproportionate negative effect on the UK 'squeezed' population.
- Whether aligning prices could encourage more use of unarranged overdrafts.
- Whether, responding to new rules, firms may seek to restrict access to unarranged overdraft for certain groups, for example by using accounts fees.

2.2. The FCA should have plans in place to monitor and respond to these potential consequences. These could include reviews of the impact of regulatory change after a specified period, covering these points, using the regulator's ex post impact evaluation framework.

2.3. Regarding promotion and advertising, we support proposed rules on the understanding they will achieve their intended outcomes. Clarity is key when it comes to effective consumer decision making. However, we believe the regulator still needs to understand better how customers use overdrafts, especially when facing other financial pressures. We would recommend it works closely with firms and consumer groups and has a plan to translate its research into effective information and guidance. Below we suggest support the SFGB could offer.

3. Our response

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

3.1. We agree with any changes that reduce the risk of detriment, especially for the most vulnerable. Data from our 2018 Financial Capability Survey show 15% of the UK adult population are 'very often' or 'fairly often' overdrawn on their current account and 8% use an unauthorised overdraft or go over their overdraft limit 'very often' or 'fairly often'¹. Close to one in three people (30%) who are already over-indebted use an unauthorised overdraft or go over their overdraft limit 'very often' or 'fairly often'².

3.2. However, we have two concerns on these proposals.

1. **Higher arranged overdraft prices (as predicted) might have a disproportionate negative effect on the UK 'squeezed' population.** Our segmentation of the UK population identifies a 'squeezed' population of 33% of UK working age adults (12.6 million people). These are individuals on modest salaries, renting or buying with a mortgage. They have many family and work pressures, are heavily reliant on credit usage and lack sufficient savings buffers to cope with unexpected life events.

Our data indicates this group is more likely to repeatedly use an overdraft than the general population. Therefore, the FCA should have a plan to monitor how likely increases in arranged overdraft prices will impact this group and respond accordingly. This would likely include using its ex post impact evaluation framework at specified point, incorporating a look at any unintended

¹ The Financial Capability Survey is nationally representative of adults aged 18+ living in the UK. In 2018, 5,974 respondents took part. This data is the result of new analysis of its findings.

² Ibid

consequences. We would suggest here that the FCA could use our segmentation model as lens through which to evaluate the impact of changes on the squeezed segment.

2. **Aligning prices (if it reduces unauthorised overdraft costs) could encourage more use of unarranged overdrafts.** We know that a significant proportion of the UK population lack confidence when making financial decisions. Only 53% would score themselves as 8 or more on a 10-point scale on how confident they feel making decisions about financial products and services. This leads to decision making that is not always rational or that meets immediate tactical needs but not longer term priorities. This is especially the case if consumers do not see overdrafts as credit, as suggested by US research³. There is the possibility this could mean even marginally lower overdraft prices might encourage people to use overdrafts, rather than exploring other options including independent debt advice.

The FCA should explore how firms can counter this through information and guidance and help customers understand the potentially negative long-term effects of using unarranged overdrafts. The SFGB is happy to work with any firm seeking to better understand how to improve customers' overall financial capability. As an example, we could work with the FCA overdraft team and stakeholders to assess the barriers to people accessing guidance and advice using our Financial Capability survey data and the FCA's Financial Lives data.

- 3.3. In addition to these concerns, we have two questions that the FCA might wish to consider when new rules are applied, potentially through putting in place pre-emptive plans to respond if certain criteria are not met (for example, if there continues to be the same level of demonstrated harm for certain more vulnerable groups).
- The CP distinguishes a group of 'heavy overdraft users' who suffer greatest harm. Would the regulator consider additional, more interventionist, rules for this 1.5% of customers, if those proposed by this document do not prove enough to protect them?
 - Does the FCA believe there is a danger unarranged overdraft costs will start to act as a price cap and arranged overdraft costs will rise to meet this?

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

³ Pew (2017), Consumer Overdraft Survey: Methodology and Topline Result

- 3.4. We agree with the proposed rules, on the understanding they will achieve their intended outcome of lowering unarranged charges. However, we believe the regulator needs to be aware that there may be a potential for unintended consequences for access because of the new rules.
- 3.5. Reducing the cost of unarranged overdrafts will reduce their profitability for firms. As a result, some may seek to restrict access to unarranged overdraft for certain groups, for example by using accounts fees, which continue to be allowed under the new rules. The FCA needs to be aware of and monitor the impact of these potential access issues.
- 3.6. If the FCA does become aware of such unintended consequences, and it should be monitoring for them using its ex post impact evaluation framework, it is key the regulator responds effectively. We would expect additional regulatory action to be looked at in this circumstance, including regarding redress mechanisms.

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

- 3.7. Although there are advantages to a single interest rate – for example, in allowing comparisons - we need to be certain that a single interest rate, alongside associated pounds and pence illustrations, don't mean consumers being overloaded with information. Our research on using behavioural science to improve debt advice has emphasised the amount of mental energy it takes to deal with finances and the importance of making decisions easy for consumers⁴.
- 3.8. Understanding this could be a focus of research before the rules are introduced, or rigorous monitoring and evaluation after introduction. It would be good to know how the FCA intends to monitor the impact of changes on competitive behaviour by consumers and whether it has a plan to respond if there is no impact. We would recommend further research and behavioural testing, either before the rules come into force or alongside early adoption.
- 3.9. It will be important for firms and the regulator to include consumer groups when deciding how to communicate on overdrafts following changes. The FCA (and firms) must remember complexity is an issue, especially for time-poor consumers, those with reduced bandwidth caused by low income or other financial pressures⁵. Complexity can distort consumer choices and behaviours, which has an impact on competition in the credit market. Overall, we would appreciate a better articulation of

⁴ How to use behavioural science to increase the uptake of debt advice (2017), Money Advice Service

⁵ FCA General insurance pricing practices market study: Terms of Reference (MS18/1) - Response from the Money Advice Service (2018), Money Advice Service

how the FCA expects firms to increase engagement with overdrafts through information and guidance, as well as pricing structures.

3.10. It is crucial, to improve customer outcomes, and increase competition, that the FCA knows how much consumers treat the cost of an overdraft as a decision point (the consultation itself says users are a mostly 'inert' group). It should also investigate the extent to which optimism bias affects decisions in this area (i.e. do consumers generally expect to exit their overdraft much sooner than they do)?

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?

3.11. The FCA will likely receive questions on why it has selected APR as a communications tool, given that this appears to run counter to findings that displaying costs in pounds and pence is more effective. It needs to have an effective answer to this. It must also remember that consumer decisions are often about cost *relative* to expectation of overdraft use.

3.12. The regulator should also consider how best firms should communicate the relative cost of overdrafts for consumers vs. other approaches / decisions. Many consumers using an overdraft, especially an unarranged overdraft, will be in severe financial difficulties. They will need to consider the rationality of further credit against seeking free, impartial debt advice. Does the FCA know what weight individuals give to overdraft costs in their decision-making process vs. other factors (for example, eligibility or non-financial demands)?

3.13. We should seek to avoid a situation where advertising encourages credit, when debt advice might be the best option. We would recommend the FCA works with consumer groups, especially the debt advice sector, to determine the best approach to this decision point.

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?

3.14. As we have noted, the main point made by the CP is that overdraft users are a mostly 'inert' group.

3.15. As argued above, this reinforces the need for consumer groups to work with the regulator and firms in trialling the best approach to communication on overdrafts, including understanding of tools such as representative APRs. When exploring this option, the FCA needs to factor in the

effects that a new focus on vulnerability might have on firm decision-making processes. It would likely be an unfortunate unintended consequence if an additional focus on vulnerability led firms to encourage the unnecessary / additional use of overdrafts as a forbearance tool.

3.16. We need to know how far consumers treat the cost of an arranged or unarranged overdraft as a decision point. Now is the time for the FCA to begin work on this questions and reflect findings in its rules. we could work with the FCA overdraft team and stakeholders to assess the barriers on people access guidance and advice using our Financial Capability survey data and the FCA's Financial Lives data.

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?

3.17. We agree with the FCA's proposal. Clarity is key when it comes to effective consumer decision making and research shows consumers understand pound and pence communications best. This is especially true for time-poor consumers and those with reduced bandwidth due to low income and financial pressure. However, the FCA needs to ensure information provided isn't overly long or complicated, which can deter consumers. Firms should consider working with consumer groups to ensure this does not occur. FCA facilitation could add value by bringing together communications expertise with overdraft providers.

3.18. It is important to remember decisions on cost are made relative to several other factors. The regulator / firms should think about how best to understand how decision-making works in a financial context and respond to this (as the *FCA Approach to Consumers* say 'regulating for the real world'). In responding, we believe industry standards can play an important role in ensuring consumers experience consistency when dealing with a range of firms.

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

3.19. In the consultation, it is unclear how the proposals on firms developing strategies to reduce repeat use are linked to the detriment identified. We would appreciate greater clarity on this issue. How does the regulator expect proposals to drive down repeated use?

3.20. We are also keen to understand why the regulator is approaching repeated overdraft use as only a driver of harm. Instead, it could be argued, repeated use of overdrafts could be considered a *consequence* of harm. For example, it could be due to considerable financial pressure in another aspect of a customer's life, such as housing costs, or utility bills.

3.21. Although FCA rules require firms to ‘Know Your Customer’ it is arguable they don’t have sufficient information on customers to determine why overdrafts are used. Overdrafts are not subject to affordability requirements. Much of the information that would allow firms to understand better why customers are using overdrafts – for example, rent data – is not consistently captured by high street banks. We would therefore recommend the regulator, firms and consumer groups need to understand better why repeat use is happening and how they can help people avoid it. We are keen to contribute to a conversation about pooling data across the financial capability sector, including financial lives data, and essential services in the best interest of consumers.