

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

Charlotte Matthews
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

4 December 2013

Dear Charlotte

Consumer Panel's response to the detailed proposals for the FCA regime for consumer credit (CP13/10)

This is the Consumer Panel's response to the Financial Conduct Authority's (FCA) detailed proposals for the consumer credit regime. I would like to reiterate the Panel's support for the FCA in taking on the regulation of this diverse and challenging sector. While we think the proposals are for the most part sensible and proportionate, there are some issues we would like to highlight as requiring further consideration. These issues are set out below. Detailed responses to specific questions are also attached.

Short-term high-cost credit

Short-term high-cost credit (which for convenience we will refer to as 'payday' lending) has been the focus of intense media and political attention in recent months. Notwithstanding this, the Panel does not feel that it is necessarily helpful to carve it out from the rest of the consumer credit sector. Many of the proposals within the consultation are aimed at ensuring people do not get into difficulty with problem debt and are not treated unfairly if they do. If the FCA is confident that its proposed package of measures are going to prove successful in this regard then they should be applied sector wide.

Problem debt can be arrived at through credit cards and overdrafts, as well as payday loans, as recent research by Which? demonstrates¹. There is no doubt that a large number of payday loan customers will be further down the debt spiral than other credit consumers and be more vulnerable to exploitation as a result.

The OFT recently found widespread non-compliance with the law and guidance in the payday lending sector². This was evident at every stage of the product lifecycle and included lenders not assessing creditworthiness and using aggressive debt collection practices. The FCA clearly needs to address this as a priority. However, it is important to remember that other forms of credit can be equally expensive and harmful. This should not be overlooked.

There is a place for payday loans as long as people understand the risks, are being sold them properly and are not using them to eat or put a roof over their heads. Better affordability checks, limiting rollovers and restrictions on Continuous Payment Authorities (CPAs) should go a long way towards cleaning up the payday lending market and ensuring consumers are better protected.

¹ <http://www.independent.co.uk/news/business/news/crack-down-on-overdraft-charges-campaigners-urge-8877807.html>

² http://www.of.gov.uk/shared_of/Credit/oft1481.pdf

It is likely that better consumer protection, through the introduction of the proposed measures, will restrict access to regulated credit for people who currently use payday lending as a means of survival. This is a social policy issue, likely to be exacerbated by the introduction of Universal Credit. While we recognise this is not a matter for the regulator, we hope the FCA is making the relevant government departments aware of the likely consequences of the new regime.

Second charge lending

The Mortgage Credit Directive is unlikely to be transposed until early 2016. Given the high risk of lending in this area, it is vital that consumers are sufficiently protected by the consumer credit regime until that point. We would like the FCA to reconsider proposals on data requirements for lenders in this area. Second charge lenders are often those who are the quickest to force possession proceedings or act unscrupulously. They need to be monitored appropriately at all times and the proposals within the consultation fall way short of being able to achieve this.

Partnership with Trading Standards

Supervising the large and diverse number of firms in this sector across the UK will be a difficult task. We would urge the FCA to ensure suitable arrangements are in place with local authority Trading Standards Services to ensure this can be achieved appropriately, particularly in relation to small and medium sized businesses such as debt collectors. The Food Standards Agency has arrangements in place with local authorities to ensure that appropriate skills are in place at a local level and there are no gaps in the supervision of food related regulation. The FCA may wish to look at this model in terms of the way it works with Trading Standards.

Flexibility

Consumer credit is a huge new area for the FCA and a big change for the businesses involved. It is impossible to predict how the market will develop or all the unintended consequences that might arise as a result of the new regime. However, it is not difficult to imagine certain firms that operate within this area seeking new ways to circumvent the rules in order to maintain profit streams. Therefore, we would hope that the FCA keeps the sector under review and adapts the regime accordingly so that consumer interests are always paramount.

Finally, we note that since the FCA issued its consultation paper the Government is bringing forward an amendment for the Financial Services (Banking Reform) 2013 Bill to cap the overall cost of credit. We will await further details on this and will engage with the FCA as it develops specific proposals for the implementation of this measure.

We hope you find these points useful and would be more than happy to discuss them in further detail if helpful.

Yours Sincerely

Sue Lewis
Chair
Financial Services Consumer Panel

Detailed responses

1, Do you have any comments on the way our threshold conditions are being applied to consumer credit firms and/or the updates to our Handbook rules?

High and lower risk activities have now been enshrined in legislation. We set out in our response to the consultation on high level proposals for the regime that a degree of flexibility was required in order to ensure individual businesses and wider business models could be moved between higher and lower risk categories quickly and easily³.

We previously provided the example of car dealerships introducing customers to lenders being categorised as lower risk. As we stated in our previous, we did not feel that this category should necessarily be rigidly applied sector wide given the large number of complaints the used car sales sector consistently generates. We continue to hold this view.

There is nothing within the consultation document to suggest any such flexibility has been factored into the system. We feel this is disappointing and is likely to lead to numerous cases where firms are deemed high risk by Trading Standards Services, based on their knowledge of wider conduct yet, having passed the lower risk threshold conditions of the Authorisations process, are subject to light touch supervision and reporting requirements regarding their credit providing activities. The reality is that if a firm is high risk in terms of conduct in one aspect of its operation, it is likely to be high risk in terms of its credit activities.

3, Do you have any comments on the updates to our draft rules regarding appointed representatives of consumer credit firms?

The Consumer Panel broadly agrees with the updates to draft rules regarding all appointed representatives of consumer credit firms. For such a system to work a high degree of professionalism will be required from the appointed representative and principal involved. The Panel believes the same is true of Exempt Professional Firms (EPF) being supervised by Designated Professional Bodies (DPBs).

Whilst we see the intended benefits of these approaches we believe that careful considerations will need to be given by the FCA to ensure they are confident that the supervising body (Principal or DPB) has appropriate levels of professionalism, can apply robust standards and have appropriate resource to supervise the associated firm or individual (appointed representatives or EPFs) they oversee. Unless the FCA is confident that this is the case, it may wish to adopt a transitional approach to such arrangements.

6, Do you agree with our proposals to collect product sales data on high-cost short-term lending and home collected credit?

We agree with this proposal and also believe that data on customers in arrears should also be collected. Furthermore, the Panel believes that these data requirements should also be applied to second charge lenders. Whilst we understand the FCA's desire to reduce the burdens on such firms until the implementation of the Mortgage Credit Directive (potentially early 2016), our view is that they pose too great a risk to consumers to be supervised on such a light touch basis.

7, Do you have any comments on how we propose to carry across CCA and OFT standards, in the particular areas highlighted above?

We previously stated that it was vital that the important protections within the current regime were brought across to the new regime. We are pleased to see this is happening

³ <http://www.fs-cp.org.uk/publications/pdf/CP-response-FCA-consumer-credit-consultation20130430.pdf>

via the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013. We also agree with the process of only repealing provisions within the Consumer Credit Act where they are replaced by rules and with the guidance that is being brought across.

We agree with the proposed rules on creditworthiness assessments. Had the guidance on creditworthiness, as set out in the Office of Fair Trading's Irresponsible Lending Guidance, been adhered to by firms previously, there would be far fewer examples of people taking on loans they were unable to pay back and many of the subsequent problems associated with the sector would not exist. However, better creditworthiness assessments must be underpinned by real-time data sharing capabilities. Creditworthiness checks will be of limited value without real-time data where consumers are able to take out multiple loans in a matter of minutes. We would urge the FCA to work with the Steering Committee on Reciprocity and others to ensure an appropriate data-sharing solution is in place.

CONC 5.2 says that an assessment of a person's ability to repay a loan needs to be carried out by a firm prior to a credit agreement being entered into. Part of the assessment includes establishing "the customer's existing financial commitments including any repayments due in respect of other credit agreements". In order for this information to be available we believe the establishment of real-time data sharing is vital. Knowing that a person has other payday loans needs to form part of the creditworthiness assessment.

The Panel agrees with the provisions under CONC 6 that subsequent creditworthiness checks need to be conducted prior to any significant increase in credit. However, we would also like to see a creditworthiness assessment required where a loan is refinanced (rolled over) and the rollover cap set at one.

The Panel feels that the rules set out in CONC on defaults, arrears handling and forbearance should provide a good level of protection for consumers in difficulty if enforced robustly. CONC 6.7.17 says that in exercising forbearance firms should ensure no additional interest or fees should apply from the date of refinancing (other than where a charge is a reasonable estimate of the cost of the additional administration required as a result of the customer having refinanced the agreement). The Panel supports this provision and believes it will help ensure debt does not spiral out of control those in difficulty. Ensuring any charge is a reasonable estimate of cost will be an important challenge for the FCA's supervision staff.

8, Do you have any comments on our proposed approach to financial promotions?

The Panel generally supports the proposed approach to regulating financial promotions relating to the credit sector and agrees with the high level principle that firms need to be clear, fair and not misleading in financial promotions. The current regime for regulating consumer credit promotions has on the whole been effective. As such we agree that creating rules for consumer credit firms that build on and enhance the current provisions, is a sensible approach.

We also welcome the intention to turn OFT debt management standards into rules and guidance. Various problems have been identified in this area including lead generators falsely complaining, or implying contact is being made on behalf of the government or charities. It is important that such practices are eradicated, particularly given they will often affect the most vulnerable.

Whilst broadly supporting the FCA approach in this area, the Panel does have concerns over the way it intends to apply warning notices to payday lending promotions only. Our concerns are set out further on this in response to question 14.

9, Do you agree with the definition of a high-cost short-term credit provider as set out at the start of this chapter?

The rigid criterion appears to invite gaming rather than future proofing against it, as intended. For example, based on the proposed definition a loan with an APR equivalent to 99% to be paid back within 12 months would not be high-cost short-term loan, but one of 100% over the same period would. We understand that the purpose of the definition is to carve out payday lending as a specific part of the credit sector, so that specific provisions can be applied to it. As we said in the summary above, we do not believe this helpful. It seems strange to differentiate this activity from other areas of credit such as home credit loans, overdrafts, etc. For example, a person borrowing £100 over fourteen weeks in the form of a home credit loan will pay back £140 with an equivalent APR of over 1000%. However, according to the proposed definition this does not constitute high-cost short-term credit and therefore provisions such as the risk warning will not apply. The Panel does not see any evidence of why the proposed provisions for payday lending should not be rolled out across the credit sector as a whole. In the absence of such evidence we believe that the measures should be applied universally.

10, Do you have any comments on limiting rollovers to two attempts?

The Panel believes that the number of rollovers should be limited to one. Like many other consumer groups, we believe that more often than not rolling over a loan is a sign that a person is in financial difficulty.

OFT recently reported that 28 per cent of loans issued in 2011/12 were rolled over at least once, accounting for almost 50 per cent of revenue in the sector⁴. Whilst rolling over loans is clearly in the interest of firms in the sector, it is not clear why limiting roll overs to two attempts is in the best interests of consumers. We understand that there may be situations where, due to unforeseen circumstances, it is in the interest of all parties to have an extended period to repay a loan. However, more than doubling the duration of the initial loan seems excessive and in many cases irresponsible.

The OFT recently reported in its compliance review that affordability checks are only carried out in 23 per cent of rollovers⁵. This is extremely worrying given a high percentage of those rolling over show signs of experiencing financial difficulties. We believe that if affordability checks were robustly carried out, rollovers would be granted in far fewer cases.

In addition to limiting rollovers, the Panel also feels that real-time data sharing is essential in ensuring people do not end up with excessive numbers of loans at the same time. Understanding a person's commitments is a key part of understanding their ability to repay a loan. It is not uncommon to hear of individuals that have had five or six payday loans at one time, which they can't afford to repay. The speed at which loans are granted is often cited as the reason for this. Real-time data sharing would overcome this and should be something the FCA encourages the industry to move to. There are examples of other jurisdictions, such as Florida in the US, where this has been achieved. It is our view that no consumer should have more than one high-cost short-term loan at any one time.

12, Do you have any comments on our proposals to introduce a limit of two unsuccessful attempts on the use of CPAs to pay off a loan?

CPAs are critical to the payday lending business models and used properly offer consumers flexibility and reduce the possibility that consumers will fail to make their payments. However, there is no question that the miss-use of CPAs has contributed to numerous incidences of distress to payday loan customers.

Payday lenders are quick to stress that the vast majority of customers repay their loan by the agreed date. For example, Wonga claim that only 3 per cent of loans, equating to

⁴ http://www.of.gov.uk/shared_of/Credit/oft1481.pdf

⁵ http://www.of.gov.uk/shared_of/Credit/oft1481.pdf

around 40,000 of their 1.25m customers, use the full 60-day loan period⁶ (where standards interest rate applies). This figure is likely to be further reduced with the introduction of improved creditworthiness checks, real-time data checks, etc. Therefore, it would not be overly burdensome for firms to contact the small number of customers where CPAs fail in order to reschedule the payment as most banks currently do. Subsequently the Panel believes the limit of unsuccessful attempts should be capped at one and missed payments rescheduled on an agreed date.

This measure, combined with a ban on taking part payments, should ensure that consumers that find themselves in difficulty are protected and allowed time to seek help. Removing every penny from a person's account through part payment withdrawals is only likely to exacerbate their difficulties.

14, Do you have any comments on our risk warning?

Findings from the BIS commissioned work into payday lending advertising suggests that there may be some merit in ensuring certain information is included in payday loan advertisements in order to help consumers make informed decisions. However, the Consumer Panel questions why this measure should be restricted to high-cost short-term lending only.

Despite claims by industry to the contrary, a large number of payday loan customers will have already be excluded from mainstream credit due to credit card and loan defaults, etc. If such warnings are deemed effective, it would surely be better to have them for all credit advertising so that consumers understand the risks wherever they enter their credit journey and not when the only credit they can access is high-cost short-term.

15, Do you have any comments on our proposal to require high-cost short-term lenders to provide information on free debt advice before the point of rollover?

We strongly support the FCA's proposal. Consumers need to understand that they have options if they are experiencing difficulty and are not required to rollover their loan if they don't deem it to be in their interest.

Whilst we support the proposal the reality is that many people that are contemplating rolling over their loan at the end of the initial loan term will already be in need of free debt advice. In addition to providing this information at the point of rollover, we suggest that the FCA requires firms to provide this information when they initially take out the loan. This provision could form part of the risk warning and again should be a sector-wide proposition.

As mentioned in the summary above, payday loans are not the only source of problem debt. As such the Panel believes that there should be a requirement for information on free debt advice to be provided by all lenders at the point where consumers miss a payment or demonstrate other signs that they may be experiencing financial difficulty.

The Money Advice Service can signpost free and impartial debt advice for consumers. We would suggest they are referenced within the information payday lenders are required to provide.

16, Do you have any comments on the effectiveness of price capping?

We note that this question was included within the consultation prior to the Government announcing its intention to table substantial amendments relating to price caps during the Third Reading of the Banking Reform Bill. The Panel had supported the pre-amendment position whereby the FCA had the option to introduce a cap should it deem necessary, based on the additional research and analysis it had committed to undertake. We will now await further details on the Government's proposal and will work with the FCA as it develops policy solutions for this measure.

⁶ <http://www.channel4.com/news/wonga-mps-business-innovation-skills-select-committee-video>

There has been a substantial amount of research conducted on the effectiveness of various methods of price capping and some of the associated issues. Within this body of literature there seems to be little consensus on the effectiveness of caps in the various forms that they exist. Therefore, we believe it will be vital that the FCA considers this area in as much detail as possible in order to develop proposals that are appropriate for conditions within the UK and that minimise unintended consequences.

20, Do you have any comments on the rules that we propose to apply to peer-to-peer lending platforms to protect borrowers?

The Consumer Panel will be responding to the FCA consultation on crowd funding and other activities. We are supportive of the FCA's proposals in this area, but feel that any new rules in this fast growing area need to be proportionate and not stifle growth. Peer to peer lending can be a valuable part of meeting unmet demand from both savers and borrowers and offers an alternative to mainstream borrowing.

21, Do you agree with our proposals for debt management firms and not-for-profit debt advice bodies that hold client money?

The Panel agrees with the proposals for debt management firms and not-for-profit debt advice bodies that hold client money. We agree that clients of smaller debt management firms should receive the same levels of protection as those of larger ones.

22, Do you agree with our proposed implementation timetable? If not, please give reasons.

The Consumer Panel agrees with the proposed timetable. However, it believes it is crucial that those posing the greatest threat to consumers are prioritised for full authorisation. We would expect that firms in the payday lending, debt management and debt collection sectors to be high priority.

23, Do you agree with our suggested amendments to the reporting requirements for second charge mortgages?

Second charge lenders are often those who are the quickest to force possession proceedings or act unscrupulously. However, the consultation proposes to that second charge firms with an interim permission will be exempt for reporting complaint data until the Mortgage Credit Directive is implemented. This is likely to be early 2016 as the final plenary vote is yet to take place. The Panel believes that, given the risk these loans pose, this proposal should be reconsidered. It also believes that second charge lenders should be required to provide information on consumer complaints and the number of customers they have in default.

24, Do you agree with our proposals to allow all micro-enterprises to complain to the Ombudsman Service?

The Panel supports this proposal.

26, Do you agree with our proposals on recording, reporting and publishing complaints?

Complaints, and how they are managed, provide a tremendous insight into the health and governance of any organisation. One clear way to improve a customer's trust and confidence is to treat them fairly, especially when things go wrong. As such, the Panel supports the FCA proposals in this area. Furthermore, we firmly believe that transparency is a legitimate regulatory tool and used effectively can be a significant factor in improving accountability, firms' behaviour and consumer welfare and protection.