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By email: [cp18-13@fca.org.uk](mailto:cp18-13@fca.org.uk)

Dear Neil,

## **CP18/13 High-cost Credit Review: Overdrafts**

The Financial Services Consumer Panel welcomes the opportunity to respond to the FCA's consultation on 'High-cost Credit Review: Overdrafts'.

The Panel's main points and recommendations are as follows:

- Rules to require firms to provide clear information and online tools to help people determine their eligibility for overdrafts are unlikely to have any significant impact.
- Rules on pre-application disclosure should also require banks to tell consumers that they can opt out of an unarranged overdraft facility and the cost of doing so.
- Alerts will not benefit consumers without savings or the means to transfer money quickly.
- A ban on all fixed fees and a single interest rate calculated in a standardised way is the best way to achieve price simplification.
- The FCA should examine whether some pricing structures for unarranged overdrafts breach CONC 7.7.5R or other existing rules.
- The FCA should consider requiring banks to provide consumers with a 'safe to spend' balance which excludes regular payments from the total.
- The FCA should require banks to draw more suitable options to the customer's attention where an overdraft is no longer the most suitable product for them.
- A price cap on unarranged overdrafts is likely to increase charges for arranged overdrafts, which are already very high in some banks. A cap should cover both.
- As part of its review of banking business models the FCA should examine the Board papers and internal analysis which support firms' pricing strategies.

**Q1: Do you agree that the threshold for application of the overdraft eligibility and overdraft alerts rules should be set at bank and building society brands (excluding private banks) with 70,000 or more PCAs?**

**Q2: Do you agree that firms should be given 12 months to comply with the proposed rules?**

We question why the FCA has set the limit as 70,000 or more PCAs by brand – it would be better if this limit was set for each institution rather than for each brand.

The rules should also be applied to current account mortgages.

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We agree firms should be given 12 months to comply with the new rules. But the FCA should consider using its temporary product intervention powers to cap charges immediately – this would enable the detriment from unarranged overdraft charges to be tackled quickly whilst it consults on proposals on the final structure and level of a charge cap.

**Q3: Do you agree with our draft rules to require firms to offer an online overdraft eligibility tool which indicates the likelihood of a consumer being eligible for an overdraft facility?**

**Q4: Should we require firms to design tools in a way that could be provided through APIs to third-party providers so that the same comparison can be run for a consumer across different banks?**

Yes. Banks are unlikely to provide a universal API solution voluntarily.

**Q5: Do you agree with our draft rules to require firms to provide clear, easy-to-read, prominent information about overdrafts to their customers before they apply for an overdraft?**

Yes, but it is very unlikely that they will have any significant impact. Information solutions do not have a good track record of leading to better consumer outcomes. These rules should also require banks to tell consumers that they can opt out of an unarranged overdraft facility and the cost of doing so.

**Q6: Do you agree with our draft rules that online calculators should be made available to show consumers how much they will be charged for their overdraft and allow consumers to calculate their costs?**

We support these rules but again think it is unlikely that they will have any significant impact on the harm identified.

PCAs are a bundle of services and it is difficult for consumers to know in advance how they might use their account. Particularly for overdrafts, consumers will find it difficult to understand how they currently use their account, be subject to optimism bias and be unable to use a simple heuristic to find a better account for them. Too often the answer will be “it depends” – it depends on how often, how much and how long they use their overdraft for and the transactions they make. For consumers to use these tools effectively they would have to know this information, have foresight for how they will use their overdraft in the future, and enter this information accurately into a number of different tools offered by the banks. As overdrafts are only one element of cost of using a PCA they would then have to combine the information from the online overdraft calculator with other information about the cost of their accounts (and also understand their current and future usage) as well as information about service availability and quality. Finally, armed with this information they would have to be certain that switching is worthwhile. This is unrealistic. Even if third party providers enter this market, comparisons would be difficult unless consumers can predict their future overdraft usage.

**Q7: Do you agree that rules requiring consumers to be automatically enrolled into unarranged overdraft and refused payment alerts should be included in the FCA Handbook?**

Yes.

However, alerts will provide no benefits to consumers without mobile/internet banking access or who don't have savings to draw on. The FCA's research found that alerts had limited impact on persistent users of overdrafts. Indeed, without further controls on the pricing of unarranged overdrafts, banks are likely to respond to lower revenues by increasing the charges they levy. This would mean that, without further intervention, the overall impact of the introduction of alerts could be negative for those consumers who are persistent or heavy users of overdrafts.

**Q8: Do you agree with our draft rules to require firms to automatically enrol their customers into arranged overdraft, unarranged and refused payment alerts?**

**Q9: Do you agree with our draft rules regarding alert channel, content, scheduling and grace periods?**

Yes, with the exception of grace periods where we believe that it would be better if the FCA included rules in the Handbook. This would ensure universal application of acceptable grace periods, rather than leave it to variable voluntary arrangements.

**Q10: Do you agree with our draft rules to require that if a firm refers to 'balance', 'available funds', or 'available balance', this must exclude any arranged overdraft available to the customer?**

Yes.

The FCA should also consider requiring banks to provide consumers with a balance which lists and excludes regular payments. Some new entrants provide this. Although the terminology needs to be clarified it is generally being referred to as a 'safe to spend' or 'smart balance'. A 'safe to spend' balance would help people budget and avoid going overdrawn, by letting them know earlier in the month so they had a better chance of managing their spending. Alerting them only when they are about to use their overdraft might be too late.

#### *Prompts*

Although the FCA does not ask about its proposed approach on the delivery of prompts (set out in paragraphs 3.85 – 3.108), the Panel is concerned that the FCA has sub-contracted out the design to a trade association. Other than a requirement to report annually to the FCA with a "sample of the material distributed" there seems to be no proper oversight. The FCA should learn from the previous experience of leaving the implementation details of remedies to industry groups and trade associations dominated by the largest banks. There are a number of examples where this approach has led to delays, only partial consideration of the options, and the lack of independent cost-benefit analysis. For example, the 2009 remedy requiring summaries of costs of current accounts specified these needed only to be provided once a year and excluded foregone interest; they took over five years to roll out across the market; and the annual summaries "as designed by banks, had no effect on consumer behaviour when considering whether they incurred overdraft charges, altered balance levels or switched to other current account providers".<sup>1</sup>

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<sup>1</sup> FCA (March 2015), Occasional Paper No.10, *Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour*, p.3

As a minimum, the FCA should monitor prompts more often and more closely and intervene if the industry is not moving fast enough or the prompts serve its own interests rather than those of its customers.

### **Pricing interventions**

**Q11: Do you agree with our approach to harm in this chapter? Do you have any comments, observations or evidence which would be relevant to this part of our analysis?**

#### *Complexity of pricing structures*

Overdraft fees and charges have become more complex and difficult to compare over the past few years, as banks have moved away from charging interest to charging daily fees, monthly fees, interest or some combination of these. Unarranged overdrafts may also have paid and unpaid item charges alongside other charges. This makes it very difficult for consumers to understand which account offers them best value, even if they anticipate using an overdraft. Often, the answer as to which account is best for them will be “it depends” – it will depend on how often, how much and how long they use their overdraft. Consumers will not possess perfect foresight about their use of overdrafts and will therefore be unable to compare between the multiple pricing structures on offer. In addition to the factors identified by the FCA which make comparisons difficult or impossible, the charging of fees within particular billing cycles (or months) means that consumers would also need to understand where they incur overdrafts across these billing cycles to understand their total cost.

FCA research also finds that consumers:

- underestimate the cost of fixed fees when comparing with interest rates;
- see daily fees in isolation and do not think about how they can accumulate; and
- tend to focus on only one part of the pricing structure even when it has several elements.

Similar research may have led some banks to move to daily fees and to start describing the cost of the overdraft as a seemingly minimal amount – for example “1p per day for each £7 borrowed”. In our view, the CMA incorrectly attributed a variety of pricing structures as evidence of competition. It looks more like evidence of price obfuscation and complexity as firms try to set prices in ways which consumers find difficult to understand or compare. We suggest that, as part of its review of banking business models the FCA should examine the Board papers and internal analysis which firms prepared as part of their pricing strategies.

The CMA also wrongly expected the Maximum Monthly Charge (MMC) for overdrafts to address some of the complexity associated with unarranged overdrafts. This was always very unlikely. Indeed, we note that one major bank chose to accompany the introduction of the MMC by increasing its daily charge. There also seems to be little correlation between the overall level of the MMC and the cost of unarranged overdrafts in a variety of different scenarios. In some cases (depending on usage) those accounts with the highest MMC can actually be some of the lowest cost. Unless they are hitting the MMC consistently then consumers choosing an account on the basis of an MMC risk being misled.

#### *Consumer detriment from unarranged overdrafts*

Unarranged overdraft fees are a type of discontinuous pricing strategy, used to exploit consumers’ financial difficulty and small errors with charges that far exceed marginal cost. The

significant customer detriment associated with unarranged overdraft charges has persisted for a very long time. Consumers have paid over £10 billion in unarranged overdraft charges since the OFT lost the Supreme Court case in 2009.

Research conducted by the FCA and others has found that:

- the transparency remedies proposed by the FCA will make little difference for persistent users of overdrafts or vulnerable consumers lacking access to mobile banking or savings.
- a large number of heavy users of unarranged overdrafts and unpaid items are not helped by automatic enrolment into alerts<sup>2</sup>.
- consumers using payday loans are more likely to use unarranged overdrafts a few months after taking out payday loans so tackling the detriment from unarranged overdrafts would help them<sup>3</sup>.
- access to high-cost credit for low income households could have a negative effect on their overall financial well-being and their ability to meet essential expenditure.
- on average, firms make over 10 times more in revenue from unarranged lending for each pound lent than for arranged overdraft lending.
- consumers are paying high effective interest rates, often more than 10% a day, for unarranged overdrafts.
- looking across unarranged overdraft users, there is no clear relationship between the level of charges and the amount they use an unarranged overdraft.
- charges for unarranged overdrafts are paid by around 14% of PCA customers but the majority of fees are concentrated on only 1.5% of customers; these consumers pay on average around £450 a year in unarranged overdraft fees.
- consumers living in more deprived areas are more likely to use an unarranged overdraft than those in less deprived areas and pay around twice as much in fees and charges
- the cost of unarranged overdrafts can be significantly greater than the cost of a payday loan<sup>4</sup>.
- with the exception of payday loans, use of unarranged overdrafts had the most negative impact on mental wellbeing of all credit products<sup>5</sup>.

This catalogue of consumer harm demands bold and decisive action, on at least the scale the FCA deployed for payday loans.

### *Breaches of existing rules*

The FCA has failed to consider that some pricing structures for unarranged overdrafts could be breaching existing FCA rules. For example, CONC 7.7.5R requires that: "A firm must not import charges on customers in default or arrears difficulties unless the charges are no higher than necessary to cover the reasonable costs of the firm." At least one bank has indicated that it uses unarranged overdraft charges to recover the credit risk, default and capital costs arising from arranged overdrafts. When it examined credit card default charges the OFT found that such practices were unfair.<sup>6</sup> The bank therefore could be in breach of CONC 7.7.5R. This calls for a full investigation and redress to be paid for any consumers affected.

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<sup>2</sup> <https://www.fca.org.uk/publication/occasional-papers/occasional-paper-36.pdf> page 4

<sup>3</sup> <https://www.fca.org.uk/insight/advancing-analytical-engine>

<sup>4</sup> Consumer Panel, CMA submission & Which? (2016)

<sup>5</sup> Royal Society for Public Health (2018), Life on Debt Row

<sup>6</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/284445/oft842.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284445/oft842.pdf)

As noted in the consultation, the Payment Service Regulations 2017 also require refused payment fees to “reasonably correspond to the payment service provider’s actual costs”. Some banks still charge up to £15-£20 for each refused payment. The FCA should investigate the extent to which the level of refused payment charges exceeds the bank’s actual costs and require any excess charges to be refunded to consumers.

**Q12: Do you have any comments, observations or evidence about the range of potential remedies we have discussed?**

**Q13: Are there other remedies we could consider to address the high level of fees or complexity of price structures? Please explain what the impact might be, why such remedies would be appropriate, and any evidence you have to support your views.**

#### *Price simplification*

We support price simplification. We suggest that a ban on all fixed fees, and a single interest rate calculated in a standardised way, is the best way to achieve this.

#### *Buffers*

We agree that the FCA should not prohibit firms from having buffers or offering interest-free overdrafts. We agree that if the consumer exceeds the buffer or the interest-free amount then interest should only be charged on the amount above the buffer rather than on the entire overdraft.

#### *Price capping*

Introducing a price cap seems to be the only way to control the level of unarranged overdraft charges. As we note above, alerts should lead to some reduction on unarranged overdraft revenue, which banks are likely to recoup from higher charges. This will increase the detriment caused to consumers in financial difficulty. However, a price cap on unarranged overdrafts risks increasing the price of arranged overdrafts, so the FCA should examine a price cap for *all* overdrafts.

The MMC set by the CMA has had very limited impact on the market. It still allows high unarranged overdraft charges to persist and does not represent a good model for the FCA to follow.

If the FCA goes ahead with an unarranged overdraft cap only, there are three possible structures:

1. Apply the current level of the cap on High Cost Short-Term Credit to unarranged overdrafts;
2. Restrict the level of unarranged overdraft equivalent to that of arranged overdrafts; or
3. Restrict unarranged overdraft charges to the net additional direct administrative costs which firms incur when consumers use their unarranged overdraft.

The level of the cap on HCSTC is too high for overdrafts. The cost structures are likely to be significantly different and banks have lower customer acquisition costs than payday lenders. They also have first claim on any money paid into the account.

The advantage of option 2 (equivalence) is that it would be simple to implement and monitor. There is no justification for the price differences between an arranged and unarranged overdraft.

In allowing the customer to go over their overdraft limit the bank is implicitly granting them an arranged overdraft.

For option 3, the net additional direct administrative costs would only include costs which can be uniquely and directly attributable to the use of an unarranged overdraft. This would require further examination by the FCA and could involve a complex calculation and close monitoring to ensure that banks do not over-exaggerate these costs. Precedents from other sectors (detailed in our previous submission to the CMA<sup>7</sup>) suggest that banks should only be allowed to charge costs such as staff, providing information/documents, premises, and IT costs. Where these costs are shared with other activities, banks would only be able to allow for a reasonable proportion of them. Banks would explicitly be excluded from charging the cost of bad debts/increased credit risk, uncollected fees, capital costs and executive staff costs.

The FCA should examine the net additional administrative costs which banks incur when consumers use their unarranged overdraft. If these are similar to those for arranged overdraft then it should implement option 2. If they are significantly different from those for arranged overdrafts then it should implement option 3.

### *Open Banking*

The FCA consultation (paragraphs 4.70-4.72) refers to the potential impact of Open Banking to reduce the complexity of overdraft pricing. However, the FCA concludes that given the potential harm in the market it is not proportionate to wait and see if technology solutions will develop to address the harm from unarranged or arranged overdrafts. We agree.

The FCA also needs to consider that Open Banking services may create additional detriment for consumers. Unbundled overdrafts provided through Open Banking services are exempt from the payday loan price cap. Open Banking services are also exempt from the controls on the use of Continuous Payment Authorities, taking a payment may cause their customers to go overdrawn. There is a clear risk that without additional controls Open Banking services could allow firms to engage in aggressive collections activity. The FCA needs to be alive to this risk and prevent harm rather than having to take remedial action after the event.

**Q14: Do you agree that repeat overdraft use is a harm that we should address? Please explain what pattern(s) of repeat use that you would consider problematic, and provide any evidence that you may have to support your views.**

Yes. Repeat use of unarranged overdrafts in conjunction with long-term use of arranged overdrafts is a particular problem. Following recent increases in the costs of arranged overdrafts, repeat and long-term use of arranged overdrafts could also be seen as creating more harm for those individuals. Some banks will now charge fees or interest equivalent of up to 50%-70% APR on arranged overdrafts which is several times the average rate on a credit card.

**Q15: Do you have any comments, observations or evidence about the range of potential remedies we have discussed, or when we should intervene?**

**Q16: Are there other remedies we could consider? Please explain what the impact might be, why such remedies would be appropriate, and any evidence you have to support your views.**

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<sup>7</sup> [https://www.fs-cp.org.uk/sites/default/files/cma\\_retail\\_banking\\_market\\_investigation\\_20160129.pdf](https://www.fs-cp.org.uk/sites/default/files/cma_retail_banking_market_investigation_20160129.pdf)

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Where an overdraft is no longer the most appropriate product then the bank should be required to draw more suitable options to the customer's attention. This could include converting a current account into a basic bank account and the overdraft into an affordable loan. Any payment plan on the loan should be based on and priced equivalently to a fixed rate loan. The FCA should also require banks to freeze interest and charges for those in financial difficulty.

It is also important that arranged overdraft eligibility should be subject to affordability and creditworthiness checks. These should include customers' other borrowing and wider financial situation. Overdrafts are a type of revolving credit and the affordability of such credit should be subject to regular review. If an overdraft is no longer affordable then it should be withdrawn gradually or converted to a term loan depending on how much the consumer can afford to repay each month.

Yours sincerely,

Sue Lewis  
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