Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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

Consumer Credit Policy
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

By email to: CP17-27@fca.org.uk 31 October 2017

Dear Sir / Madam,

CP17/27 Assessing creditworthiness in consumer credit – proposed changes to rules and guidance

This is the Financial Services Consumer Panel's response to CP17/27: Assessing creditworthiness in consumer credit – proposed changes to rules and guidance.

The Panel welcomes the FCA's efforts to make clear that lenders must base their decision to lend not solely on credit risk but also consider affordability.

However, the Panel disagrees strongly with the FCA's assessment that existing processes are adequate. If affordability checks were already working well, we should not see significant numbers of people struggling to repay their borrowing. For example:

- The FCA found that 17% of people with outstanding consumer credit suffer moderate to severe financial distress (equivalent to 2.2m people)[1]
- It also found that 7.7m adults are over-indebted as they find keeping up with their bills and credit commitments a 'heavy burden', or that they have missed payments for bills or credit commitments in three or more of the last six months[2]. This is broadly consistent with Money Advice Service research, which estimated 8.3 million adults are over-indebted using the same measure.
- StepChange found that 2.9 million people are struggling with severe debt problems and over 9 million more are showing signs of financial distress. It reports that demand for debt advice is growing, and the average unsecured debt of their clients has increased for the first time in eight years (up from £14,251 in 2016 to £14,367 in the first half of 2017).

This degree of over-indebtedness cannot be explained by sudden and unforeseen changes in people's circumstances that cause them to fall behind on household bills or debt repayments. It should also be noted that being over-indebted is not confined to people on very low incomes but extends up the income scale[3]. The notion of 'obvious' affordability is fraught with difficulty, as even a small loan can push someone over the edge if they have other debts which they are struggling to repay but may not have defaulted on.

[1] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-20.pdf
[2] https://www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf, p.140
[3] See, for example, Citizens Advice report 'A debt effect?', p.10 at https://www.citizensadvice.org.uk/Global/CitizensAdvice/Debt%20and%20Money%20Publications/The%20Debt%20Effect.pdf and 'A Picture of Over-Indebtedness', MAS (March 2016) which found there is a relationship between over-indebtedness and household income, but it is not as strong as might be expected. Above £10,000, household income is not strongly associated with over-indebtedness, with all income bands having similar probabilities of being over-indebted (around 15%). Analysis suggests that above £10,000, other factors (e.g. number of children) are more important.

The Bank of England's Statement on consumer credit said that "*rising consumer indebtedness and its impact on borrowers' ability to repay their debt in the future was not always fully considered in firms' assessment of risk. For example, underwriting assessments did not always take into account a customer's total debt (including secured), nor was this routinely monitored for existing customers. Further, underwriting assessments rarely assessed how future shocks (for example to housing costs) could affect borrowers' ability to repay*".[4]

Andrew Bailey has expressed concern about consumer credit[5]. In a recent Mansion House speech, he noted that "*some of the terms encourage over-indebtedness with little or no incentive to pay down debts*"[6]. Quite. Firms' practices are highly profitable and there is no first mover advantage to lending affordably. The FCA will need to mandate it.

The FCA should not shy away from building greater friction into the process of applying for borrowing. It is better for the FCA to force firms to undertake a more thorough affordability test when deciding whether to lend (or lend more), rather than relying on debt advice agencies to provide remedial assistance when consumer harm has already occurred. A degree of consumer inconvenience is a small price to pay for reducing the misery of over-indebtedness.

We do not underestimate the impact on availability of credit of thorough affordability checks. However, it is neither good for individuals nor the economy to have millions of people struggling with unaffordable debt.

The FCA should have a clear vision of what a good consumer credit market looks like for consumers, not fiddle around piecemeal with rules and remedies in different parts of the market.

The Panel has some other general points to make about the proposals:

- **Measuring the outcome of proposals –** The FCA says it will judge success by looking at firms' processes and procedures, and complaints. This relies heavily on supervision and means risks are identified only after they have crystallised. For flexibly supervised firms, poor conduct may go unchecked for a significant time. This runs contrary to the 'preventative' mantra of the Mission. Complaints data gives only a partial picture and, again, is 'after the event'. The FCA should define what consumer outcomes it is seeking to achieve, and appropriate metrics to chart its progress.
- **Use of debt-to-income (DTI) ratios –** The FCA's Consultation Paper and associated Occasional Paper provide compelling evidence that "*affordability risk may be high where the total value of the customer's debts relative to their income is high*". While this evidence relates mainly to high-cost short term credit, it seems likely to hold equally across other credit products. Given these findings, the FCA should consider mandating firms to make use of DTIs when conducting affordability assessments. The implementation of open banking and PSD2 could enable firms to conduct this type of assessment in cost-effective ways.
- **Application to online lending –** Increasingly, customers apply for credit online. This relies on automated lending decisions, underpinned by algorithms. The FCA should ensure that its proposals on assessing affordability are applicable to firms that lend online. This should include proactive supervision and scrutiny of lending decisions, and the requirement for firms to evidence this. The FCA should also run firms' algorithms on test data.

  The FCA should also clarify lenders' obligation to identify vulnerability for all lending channels. It should encourage firms to make use of data embedded in the digital

[4] http://www.bankofengland.co.uk/pra/Documents/publications/reports/prastatement0717.pdf
[5] https://www.theguardian.com/business/2017/sep/18/britain-debt-timebomb-fca-chief-crisis
[6] https://www.fca.org.uk/news/speeches/challenges-regulator-mansion-house-2017

journey to identify consumers who are experiencing decision-making difficulties, or require additional support[7].

- **Multiple cards and other borrowing –** The proposed affordability framework does not adequately take account of multiple holdings of credit products. As the FCA notes in its Consultation Paper, incremental increases in card limits create affordability risk. This risk is exacerbated where consumers have multiple cards or other credit products. For example, a consumer could take out a credit card with a £5,000 limit but not use the card. The same person could later take out another card with a £10,000 limit and borrow up to their limit. Borrowing against the £5,000 limit could then be unaffordable but there is no requirement on the original card issuer to conduct any further affordability assessment. The failure to take account of multiple borrowing is a significant weakness in the FCA proposals. A more holistic assessment is required. **The Panel has called before for the FCA to work with industry and consumer groups to develop a simple rule of thumb about what the maximum unsecured consumer credit limit should be for an individual, based on affordability.** Getting a grip on affordability is all the more important given that interest rates are likely to rise sooner rather than later.
- **Increasing risks from online payday lending:** Open banking will enable online lenders to use consumers' data to offer running-account credit, moving money into the account and collecting repayments automatically by constantly monitoring customers' transactions and account balances. Under the existing rules providers will only have to conduct an affordability assessment at the time the credit limit on the overdraft is granted, not when the consumer borrows against the limit. The new breed of auto-payday lenders could also take advantage of a loophole in the FCA's rules which only require another affordability assessment when there is a "significant" increase in a credit limit. There should be a requirement to conduct regular affordability assessments for these products.
- **Exclusion of unarranged overdrafts:** We do not agree with the exclusion of unarranged overdrafts from the proposed rules. This form of credit comes with very high charges – in some cases in excess of the cost of payday loans – and should not be exempt.

In addition to answering the consultation questions, we have provided a separate paper, on the drivers of over-indebtedness, and some suggested policy options.

Yours faithfully

Sue Lewis
Chair, Financial Services Consumer Panel

[7] https://www.moneyandmentalhealth.org/online-loans-using-data-see-difficulty/

Responses to questions

1. **Do you agree with our proposed changes to the scope of the creditworthiness rules and proposed transitional arrangements?**

   The proposals do not go far enough. In particular, we want to see firms take into account all credit products held by a customer so they have an accurate picture of the debt to income ratio.

2. **Do you agree with our approach to the meaning of affordability and the factors that should be taken into account by firms?**

   Yes. We are concerned, however, that firms will implement this as a box ticking exercise (particularly where the lending is online and mostly or fully automated). The FCA has sought to balance regulatory prescription and ease of access to credit and erred towards the latter. Allowing firms to take a flexible approach to affordability and relying on post-hoc supervision and monitoring is a recipe for continued consumer harm.

3. **Do you agree with our proposals on the use of income and expenditure information?**

   No. The FCA should impose more stringent requirements on firms to establish affordability via income and expenditure. This should include all the other credit products held by the customer. We are also concerned that firms could assume a minimum level of income if a customer is in a particular type of employment. Quite apart from the fact the estimate may be wrong, it does not take account of other borrowing, and enables consumers to game the system by picking an occupation that is not checked.

4. **Do you agree with the factors which we propose that firms should have regard to when considering proportionality of processes for assessing creditworthiness including affordability?**

   No. We believe that a debt to income ratio (DTI) that takes into account all the borrower's credit commitments should be an important part of assessing affordability. The FCA's research has shown that a high DTI is a powerful predictor of future financial distress. Debt to income ratios should be verifiable from external data sources. Access to transaction data through Open Banking may help[8] by reducing the risk of borrowers or lenders gaming the system or treating affordability as a tick box exercise.

5. **Do you agree with our proposals for open-end and running-account credit, guarantor loans and peer-to-peer loans?**

   We welcome the FCA's proposals to provide more regulatory certainty on the likely duration of credit. We question whether a more sophisticated method is possible rather than relying on the assumptions set out in para 5.61 which do not reflect usual credit card usage. Would analysis of aggregated customer data not be a better guide?

[8] While we see potential for Open Banking to help firms conduct better affordability assessments, we are also concerned that the same data can be used by firms to exploit consumers through targeted marketing of credit and other products.

We support the new requirements for guarantor lenders to assess potential harm on the guarantor's financial situation; and the changes proposed for peer-to-peer lending.

6. Do you have any views on our proposals in relation to firms' policies and procedures for creditworthiness assessment?

We support the FCA's proposals to clarify its expectations in relation to these policies and procedures. However, we would like to know how monitoring polices and procedures is consistent with a preventative approach. Most lenders are flexible firms, and harm may not be evident for many years.

7. Do you have any views on the use of CRA data and products, or other data sources, as part of an assessment?

The CRA system is not fit for purpose. As the Consultation Paper notes, some data sources are not shared (e.g. rental payments); firms are not required to share data to all CRAs; CRA data can be inconsistent, incomplete, and out of date. In addition, their primary purpose is to assess creditworthiness, rather than affordability. The upshot of this is that affordability assessments may not be accurate, calling into question how far firms can, or should, rely upon them.

The move to real-time data sharing has been too slow and the FCA should press industry to move faster on this. The discrepancies in data for the same customer suggest that CRAs need to work to improve the consistency and quality of the data they hold.

The Panel also recommends that the FCA review the CRA sector to evaluate its effectiveness, and consider imposing minimum standards to raise performance in the sector.

8. Do you have any other comments on our proposed changes to CONC in relation to creditworthiness including affordability?

No.

9. Do you agree with our assessment of the costs and benefits of the proposed changes?

Yes, though we do not consider that the proposed changes go far enough.

10. Do you have any comments on the equality and diversity implications or other aspects of our proposals?

No.

Appendix - Over-indebtedness: the drivers in the financial services market and the policy responses to prevent them

Introduction

In 2016, the Financial Conduct Authority completed a review of the Credit Card Market in the UK. It concluded that, while competition was working "fairly well" for most consumers, it was concerned about the scale, extent and nature of problem credit card debt. Further, it was concerned about the lack of incentives on firms to reduce this. The study identified over five million people in the UK as being either in arrears or having defaulted, or carrying a debt greater than 90% of their credit limit for at least 12 months, or were repeatedly making minimum payments on their credit card debt. Over 5 million accounts active in January 2015 would, on current repayment patterns, and assuming no further borrowing, take more than 10 years to pay off their balances[9]. It is the Panel's view that the FCA's principle of Treating Customers Fairly (TCF) has failed in the credit card market, and that the remedies proposed are insufficient to meet the requirements of that principle. A duty of care would be clearer and more effective.

In November 2016, the Bank of England issued a warning about the high level of debt in UK households, with consumers borrowing more on their credit cards and other unsecured debt[10]. In June 2017, the Bank of England's Stability Report found that consumer credit grew by 10.3% in the twelve months to April 2017 – markedly faster than nominal household income growth, with credit card debt growing rapidly[11].

The debt advice charity StepChange stated in its 2016 Year Book[12] that there was a record demand for its advice last year, with nearly 600,000 people contacting them for help – or one person every 53 seconds. The average debt of clients earning less than £30,000 increased by £569; to £12,897. The average debt of clients earning more than £30,000 stood at £29,340. For the first time in eight years, the overall average unsecured debt of its clients increased. On average in 2016, clients had 5.7 unsecured debts, including almost three credit cards. Overall, more than two-thirds of clients owed money on credit cards, and over half had overdraft debts. Only 16% of average debt was in the form of payday loans. In addition to unsecured credit commitments, four in ten people were behind on their household bills, adding to their debt burden.

In its recent report on vulnerable customers in regulated industries[13] (including water, energy, telecommunications and financial services sectors), the National Audit Office concluded that an estimated 8 million people are over-indebted, "with expected rises in household debt potentially putting further pressure on finances". It also found that the most common issue for consumers across the four industry sectors it examined was dealing with debt. Further, unexpected high charges, mis-selling and aggressive debt collection can lead to hardship and distress. This is particularly the case when individuals are struggling with a number of problems at the same time. Given that each individual regulator only has regard to the products and services within its own remit, it is extremely difficult to build a picture of the extent to which the actions or inactions of one sector or product group create wider consumer detriment. However, it is essential that we gather evidence to understand the drivers of over-indebtedness, and the role of credit in the financial services sector within those drivers, so that the regulator can make the appropriate intervention.

"People suffer financial distress when they face financial and non-financial difficulties from repaying their outstanding debts. Financial distress may mean that individuals file for bankruptcy or increase working hours, take on additional jobs, or reduce spending in order to meet repayments. Financial distress may also have wider non-financial effects,

[9] https://www.fca.org.uk/publications/market-studies/credit-card-market-study
[10] Financial Stability Report, Bank of England, 30 November 2016
[11] Financial Stability Report, Bank of England, 27 June 2017
[12] StepChange, 2016 Statistics Year Book
[13] Vulnerable Consumers in Regulated Industries, National Audit Office, 31 March 2017

such as stress, along with other forms of mental and physical distress or social stigma. Through missing repayments or persistently maintaining debt financial distress may also impede a person's future ability to access credit."[14]

High levels of indebtedness are correlated on average with higher risks of insolvency[15], bringing misery to consumers and damaging the economy. Over-indebtedness increases the risks of financial instability. The current situation therefore demands a policy response from regulators.

The Panel is proposing that the regulators of the UK financial services industry consider both ex ante and ex post interventions, to prevent over-lending and excessive risk-taking by banks, and to deliver a fairer allocation of credit risks between consumers and lender. The Panel believes this is the time for bold regulatory intervention to change firms' attitudes towards the financially fragile, in order to end the misery of over-indebtedness driven by debt built up on credit cards and improve the financial stability of the UK as a whole.

The causes of over-indebtedness

In the UK, over-indebtedness is defined as the situation in which a "household or an individual is in arrears, on a structural basis, or at a significant risk of getting into arrears on a structural basis[16]. The words "structural basis" suggest a long term problem with repaying debt, rather than a short term issue.

Driver 1: The number of credit commitments a household has

Research conducted by Civic Consulting, in cooperation with the Personal Finance Research Centre at the University of Bristol[17], found that the use of multiple unsecured credit products is positively associated with the likelihood of arrears. The greater the number of credit commitments households had, the more serious was the level of arrears. The total amount of money borrowed had much less effect. But a significant positive correlation was found between the level of consumer debt outstanding at the aggregate level and the frequency of arrears on hire purchase and other loans.

The researchers also cited previous research that supports the hypothesis that higher levels of outstanding consumer credit put households in a riskier financial position: they are more likely to have arrears on hire purchase or other loans, and arrears on utility bills. It is this wider picture of over-indebtedness that the financial services regulator might miss if their evidence gathering is limited to a single product or financial services products only.

In the FCA's Occasional Paper[18] researchers found that, using one method of measuring financial distress that combines both objective and subjective measures, 17% of people with outstanding consumer credit debts are in moderate to severe financial distress.

Further research[19] has shown that the more credit commitments a household has, and the larger the proportion of their income that went towards repayment, the more serious the level of arrears, where arrears include commitments such as utility bills and council tax. In the UK, compared with non-users of credit, the odds of arrears for those with one credit commitment was increased by a factor of 1.6, rising to 3.7 for those with 2 commitments, and 5.8 for those with 3 or more credit commitments. The FCA did not

[14] Gathergood and Guttman-Kenney, FCA Occasional Paper 20, "Can we predict which consumer credit users will suffer financial distress", published 3/8/2016, updated 17/2/2017
[15] Two Dimensions of Combating Over-Indebtedness – Consumer Protection and Financial Stability, Sylvain Bouyon, Roberto Musmeci, October 2016
[16] Oxera 2004.
[17] The over-indebtedness of European Households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact, Collard S., Finney A., Kempson E., 2014
[18] Gathergood and Guttman-Kenney, FCA Occasional Paper 20, "Can we predict which consumer credit users will suffer financial distress", published 3/8/2016, updated 17/2/2017
[19] Kempson E., McKay, S., Wilitts, M., Characteristics of families in debt and the nature of indebtedness, Department for Work and Pensions, 2004.

consider this evidence in its credit card credit card market study, so the extent of consumer detriment has not been fully examined.

Driver 2: higher and average interest credit

In the UK, regulated credit or loans with average interest rates were most frequently cited in research[20] as causes of over-indebtedness, in terms of the type of credit or loans taken out by over-indebted households. The most common types of credit were credit cards, overdrafts and bank loans, as well as credit with shops and mail order catalogues.

The research also found that high levels of borrowing are an important determinant of financial problems when an individual or household experiences an income fall. So, higher levels of borrowing increase household vulnerability to exogenous macro-economic shocks.

Driver 3: the ratio of unsecured debt to income and the level of mortgage income gearing

While there is no clear correlation between the level of indebtedness and frequency of arrears, research in the UK[21] has found that, although there is no clear point at which debt becomes problematic, there is a link between both the ratio of unsecured debt to income and the level of mortgage income gearing, leading to a higher probability of debt being a burden on households. The Bank of England has clearly recognized this interrelationship between the level of unsecured debt and mortgage debt, and its measures to control the activities of mortgage lenders are now well established. This finding is also consistent with research published by the ECB[22], which found that, all other things being equal, sharp rises in the debt ratio puts households in a riskier financial position.

The FCA research into the role of debt to income ratios[23] found that the 10% of people with the highest debt to income ratios are much more likely to suffer financial distress in the future than those with lower ratios. The type of debt is also important: individuals with the majority of their debt in higher cost products are much more likely to experience financial distress than individuals whose debts are mostly in other forms. They suggested there should be a role for affordability policies that take such factors into account. Citizens Advice estimates the ratio of unsecured household debt to income is set to reach between 20% and 24% by the first quarter of 2021, potentially surpassing the pre-banking crisis peak[24].

Driver 4: behavioural biases

Behavioural biases also come into play when examining the causes of over-indebtedness. Research for StepChange[25] found that households borrow when times are good, and increase their spending on credit even when this is outpaced by any actual earnings growth. They also exhibit "head in the sand" behaviours, such as using new credit to repay other credit, underestimating the amount of money owed, and failure to seek advice at an early stage. It has also been found across the EU that young people are particularly likely to have poor money management skills.

---

[20] The over-indebtedness of European Households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact, Collard S., Finney A., Kempson E., 2014

[21] Gathergood and Guttman-Kenney, FCA Occasional Paper 20, "Can we predict which consumer credit users will suffer financial distress", published 3/8/2016, updated 17/2/2017

[22] Rinaldi, L., and Sanchis-Arellano, A., Household debt sustainability – what explains household non-erforming loans? Working paper series no 570, European Central Bank, 2006.

[23] Gathergood and Guttman-Kenney, FCA Occasional Paper 20, "Can we predict which consumer credit users will suffer financial distress", published 3/8/2016, updated 17/2/2017

[24] Citizens Advice, "Unsecured and insecure? Exploring the UK's mountain of unsecured personal debt – and how it affects people's lives", September 2015

[25] Collard, S., Finney, A., and Davies, S., Working households' experiences of debt problems. Personal Finance Research Centre, Bristol, 2012

Research in the UK[26] found that young householders are at much higher risk of debt problems than students, but the latter seem to attract more attention than the former. The proportion of StepChange clients aged under 40 continues to grow. In 2016, they accounted for 60% of all clients advised, whereas five years previously they accounted for 52%. Analysis by Citizens Advice[27] found that young people "shoulder a disproportionate amount of unsecured debt in the UK". The under 35s make up 29% of the adult population, but hold 48% of the debt. Citizens Advice said, "the rate at which young people have been accumulating debt over the last few years is a cause for renewed concern. While the average level of debt grew by nearly 20% between 2006 and 2012, the debt of 15-24 year olds grew more than ten times faster (by 206%) over the same period".

Research by the Money Advice Trust[28] found that two thirds of 18 to 24 year olds have borrowed money from family and friends, borrowing an average of £2248 overall. A quarter of those questioned have borrowed from family and friends to pay for food, 15% to cover one or more rent payments, and 15% to cover travel costs.

Research for the FCA[29] also examined the characteristics of those in financial distress. They found them to be typically younger, with lower incomes, less likely to be employed and having higher debt-to-income ratios. They were also more likely to hold higher-cost credit products.

This psychological element is also discussed by Bouyon and Muscmeci[30]. They say that it is unrealistic to assume that households are fully aware of the risks related to financial products, that they are able to accurately predict all their life events and that they take the necessary measures to preserve the sustainability of their financial commitments. They add that a financial shock (a drop in income or increase in outgoings) catalyses the problem of over-indebtedness. But irresponsible lending acts as a complementary driver.

In conclusion, the interdependencies between different forms of debt, the aggregate levels of debt, and the possibilities of economic shocks caused by life events or changes to the macro-economic environment mean that policy makers need to take a much more holistic view of personal unsecured debt when considering the detriment caused by different products and effective interventions.

Possible Policy Responses

This market attracts some of the most vulnerable consumers, and effective regulatory interventions by the FCA are essential to prevent exploitation of the financially distressed.

However, current interventions are based on crystallised problems. An unwillingness to seek advice early means that, all too often, debt advice comes when consumers present with complex cases involving several creditors. The cost of resolving these cases is significantly higher than would be the case with early intervention. Early identification of those becoming over-indebted should benefit both consumers and firms, but only if product pricing is not designed to exploit the vulnerable.

The Panel is also concerned that those who do not seek help with their over-indebtedness could be lured into unauthorised lending. The NAO estimates that 310,000 people in the UK are currently borrowing money from illegal money lenders[31]. More

---

[26] Collard, S., Young adults' credit decisions: A report to Capital One from the PFRC (University of Bristol), 2012

[27] Citizens Advice, "Unsecured and insecure? Exploring the UK's mountain of unsecured personal debt – and how it affects people's lives", September 2015

[28] Money Advice Trust, Borrowed Years – A spotlight briefing on young people and borrowing from family and friends, November 2016

[29] Gathergood and Guttman-Kenney, FCA Occasional Paper 20, "Can we predict which consumer credit users will suffer financial distress", published 3/8/2016, updated 17/2/2017

[30] Two Dimensions of Combating Over-Indebtedness – Consumer Protection and Financial Stability, Sylvain Bouyon, Roberto Musmeci.

[31] Vulnerable Consumers in Regulated Industries, National Audit Office, 31 March 2017

research is needed to understand the extent to which victims of loan sharks have first taken on debt provided by regulated lenders and exhausted regulated borrowing options.

Preventing over-lending in the first place, regulating pricing structures such that business models are not designed to profit from the misery caused by over-lending, and requiring much earlier identification of the "financially fragile" and effective intervention by firms would result in better outcomes for consumers.

The policy proposals below are intended to address these issues.

1. The definition of "over-indebtedness" in the UK refers to arrears. In the credit card market, the levels of minimum repayment are so low as to be meaningless. As long as minimum payments are made, a borrower is not "in arrears". As the research for the FCA's Credit Card Market Study shows, borrowers can carry high levels of debt on credit cards without being deemed to have problematic debts by their lenders. **Minimum repayments need to rise to a meaningful level to ensure credit card debt is repaid faster, and to identify earlier those who cannot keep up with payments**. **The FCA should undertake analysis to inform and identify possible options to achieve these objectives.**

2. In 2014, the French government enacted a Charter on Banking Inclusion and Over-Indebtedness Prevention. This requires lenders to design mechanisms for early detection of financially fragile customers, combined with an internal warning system. They must develop a specific device "allowing the detection of situations of financial hardship faced by their clients towards the contracted financial products… taking into consideration the profiles of their clients and their financial behaviour".

   The FCA should require lenders in the UK to develop systems that adequately identify their financially fragile clients. This might include a requirement for lenders to set up their own units dedicated to this activity, which would develop expertise and greater understanding of consumers likely to become over-indebted, and for these units to be trained to treat borrowers sensitively to encourage engagement. Consumers should not be penalised for taking action early to deal with their debt.

3. The FCA's proposed interventions to deal with 'persistent debt' are inadequate and place insufficient incentive on firms to lend responsibly. It is simply incredible that the FCA doesn't regard persistent debt – making minimum repayments and paying more in interest and charges than principal over two 18 month periods – as a sign of struggling. The FCA doesn't even comment on whether it believes the costs of carrying debt for this long – on average £2.50 in costs and charges for every £1 principal repaid – are excessive. **The FCA needs to be bolder and reduce the time limits. It should carry out a proper cost-benefits analysis, which models more ambitious timeframes for intervention, and looks at the wider costs and economic impact of 'persistent debt' and overindebtedness. It should also examine the role of credit card debt on the wider financial situation of the financially fragile, and introduce a requirement for firms to freeze interest and charges once the prescribed time limits are reached.**

4. Responsible lending requires a proper assessment of affordability, which examines the ability to repay. The Lending Code requires this of all lending. However, such affordability checks have not been carried out by credit card lenders who offer unsolicited credit increases on the basis of credit scoring alone. Credit risk tests protect the firm; affordability tests would protect the customer. The Panel considers firms' failure to carry out such affordability checks to be a failure of the FCA's principle to Treat Customers Fairly (TCF). **Affordability**

checks should be required across all forms of debt. The interdependencies identified earlier in this paper should be recognised in such affordability checks.

Credit card regulation in Australia

In Australia, credit licensees must comply with the responsible lending conduct obligations in Chapter 3 of the National Consumer Credit Protection Act 2009. The key concept is that credit licensees must not enter into a credit contract with a consumer, suggest a credit contract to a consumer or assist a consumer to apply for a credit contract if the credit contract is unsuitable for the consumer. RG 209 sets out the regulator's expectations for responsible lending:

"Meeting your responsible lending obligations will require taking three steps:

1. Make reasonable inquiries about the consumer's financial situation, and their requirements and objectives;
2. Take reasonable steps to verify the consumer's financial situation; and
3. Make a preliminary assessment (if you are providing credit assistance) or final assessment (if you are the credit provider) about whether the credit contract is 'not unsuitable' for the consumer (based on the inquiries and information obtained in the first two steps).

In addition, the 2017 Budget announced that credit cards will in future be subject to affordability assessments involving paying off the balance within a reasonable period; a ban on unsolicited offers (of new cards or increased credit limits); and banks must offer the opportunity to cancel the card or reduce the credit limit online.

5. The systems used by lenders to assess creditworthiness need to support the objective of identifying the financially fragile by creating a complete picture of borrowers' commitments. This view is supported by the NAO, which recommended that regulators and government should "more proactively explore options to enhance data-sharing that would allow better identification of, and support for, consumers in long-term or permanent vulnerable circumstances"[32]. **The FCA should mandate that all firms notify new lending commitments to all CRAs serving the UK market. Anomalies between different debt products also need to be removed so that all lenders, irrespective of the debt product they offer, share real-time data with Credit Reference Agencies to facilitate more accurate assessment of borrowing requests.**

6. The FCA has also announced voluntary remedies to give customers greater control over their credit limit. A 2016 StepChange survey of its clients seeking debt management advice found that 54% of those with credit cards had seen their limit increased without them asking for it. Of those, 40% said this had made their debt problems worse. The opt-in opt-out choices can easily be "gamed" by the industry, and consumers could be confused by the different choices on offer. The measure is over-complex, and goes against the general direction of travel in terms of clear and unambiguous informed consent, as set out in the General Data Protection Regulation issues by the Information Commissioner's Office. There is no consumer benefit to unsolicited credit limit increases, and the potential for considerable harm. **The FCA should follow the example of Australia and ban all unsolicited credit limit increases**.

[32] Vulnerable Consumers in Regulated Industries, National Audit Office, 31 March 2017

7. In the mortgage market, lenders know the amount of money a consumer has borrowed against their property, creating a ceiling for such borrowing for each consumer. It should not be possible for consumers to hold levels of credit card debt far in excess of their monthly disposable income, other than for very short time periods. **There needs to be a debate led by the FCA to establish whether a similar overall limit should apply to unsecured borrowing, and what that limit should be.**