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By email: cp18-42@fca.org.uk

Dear Sara,

CP18/42 High-Cost Credit Review: Overdrafts consultation paper and policy statement

The Financial Services Consumer Panel welcomes the opportunity to respond to the FCA's consultation on 'High-cost Credit Review: Overdrafts'. The Panel commends the analysis conducted by the FCA and its package of proposals to address the significant and longstanding detriment caused to consumers, and looks forward to its speedy implementation.

The Panel agrees with the FCA that fundamental change is needed in the overdraft market. Its main points and recommendations seek to build on the FCA's proposals and ensure they protect consumers, by making overdrafts simpler, fairer and easier to manage:

- The FCA proposals should be implemented together as a single package. Without the single interest rate, it is likely that banks will find it easier to increase the cost of arranged overdrafts by using complex and opaque pricing structures which are difficult for consumers to understand or compare.
- The Panel agrees that FCA's proposals to align arranged and unarranged charges should help to tackle the consumer detriment from excessive unarranged overdraft charges, and should be simple to implement and monitor. There is no justification for the price differences between arranged and unarranged overdrafts since, in allowing the customer to go over their overdraft limit, the bank is implicitly granting them an arranged overdraft.
- Given the detriment caused by the current level of unarranged overdraft charges, the FCA should move as swiftly as possible to introduce the alignment of arranged and unarranged charges.
- The Panel recommends the FCA keep overdraft charges under review and be ready to take further action, including introducing a price cap, if the banks fail to respond positively to the current proposals.
- The FCA proposals for a ban on all fixed fees and a single interest rate calculated in a standardised way is the best way to achieve price simplification.
- It would be helpful for the FCA to provide clear guidance that the cost of refused payment fees should represent the "actual costs" incurred by banks. In addition, the FCA should review the level of these charges and require any charges levied in breach

of the existing Payment Service Regulations to be automatically refunded to consumers.

- The FCA should consider requiring banks to draw more suitable options to the customer's attention where an overdraft is no longer the most suitable product for them, and to freeze interest for consumers in financial difficulty.
- Overdrafts for micro-businesses perform the same function as those provided to personal customers. They are also open to the same exploitation. The FCA's proposals should apply equally to them.
- Products marketed to consumers as having the same function as overdrafts should be subject to the same rules. This should include products such as Open Banking-enabled unbundled overdrafts.

Consumer detriment from unarranged overdrafts

Unarranged overdraft fees are a type of discontinuous pricing strategy which 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 Office of Fair Trading (OFT) lost the Supreme Court case in 2009.

Research conducted by the FCA and others has found that:

- while the transparency remedies proposed by the FCA may help occasional overdraft users with readily available funds, they will make little difference for persistent users of overdrafts or vulnerable consumers lacking access to mobile banking or savings.
- many heavy users of unarranged overdrafts are not helped by automatic enrolment into alerts, and continue to incur unpaid item charges¹.
- consumers using payday loans are more likely to use unarranged overdrafts a few months after taking out payday loans. Tackling the detriment from unarranged overdrafts would therefore also help them².
- 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 from 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 people use an unarranged overdraft (in terms of pounds borrowed over time).
- 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 and tend to have lower incomes, to be from Black, Asian and minority ethnic (BAME) communities, and are more likely to be vulnerable due to poor health or a disability.
- consumers in more deprived areas are 70% more likely to use an unarranged overdraft than those in less deprived areas and pay around twice as much in fees and charges.

¹ <https://www.fca.org.uk/publication/occasional-papers/occasional-paper-36.pdf> page 4

² <https://www.fca.org.uk/insight/advancing-analytical-engine>

- the cost of unarranged overdrafts can be far greater than the cost of a payday loan³.
- with the exception of payday loans, use of unarranged overdrafts had the most negative impact on borrowers' mental wellbeing of all credit products⁴.

We welcome the package of measures proposed by the FCA to tackle these harms. The Panel believes that it is vital these reforms are implemented as soon as possible and that all elements of the proposals are implemented as a single package.

As the FCA takes forward its proposals to reform overdraft charges to make them simpler, clearer and fairer, the Panel suggests the FCA should also consider requiring banks to provide redress to consumers who have been subject to high charges. The Panel does not see how charging customers interest rates of 40% or 50% a day can be consistent with 'treating customers fairly'. The Panel also considers that the FCA should review whether banks overdraft charging structures have breached CONC 7.7.5R

Our responses to the questions posed in the consultation document are set out below.

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

Yes. The advantage of aligning the charges for arranged and unarranged overdrafts 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.

The FCA should keep under review the need to introduce a price cap on all overdrafts depending on how banks respond to the proposals.

Q2: Do you agree with our analysis that our rules on alignment should not allow firms to charge more for unarranged overdraft use (no uplift)? If you disagree with our analysis, please provide evidence outlining the additional costs an uplift is required to cover and the level of uplift required.

Yes, we agree that the rules should not allow firms to charge more for unarranged overdrafts.

Firms have been unable to provide the FCA with any clear evidence that unarranged overdrafts cost more than arranged overdrafts. To allow an uplift would cause detriment to consumers using unarranged overdrafts and risk exacerbating financial difficulty. It would also give an incentive for firms to withdraw arranged overdrafts from consumers who are in financial difficulty or struggling with their arranged overdraft in order to raise the price paid by the consumer. This is already the policy pursued by some firms and one which we believe is inherently unfair, damaging to consumers, and which would appear to breach Principle 6 (Treating Customers Fairly) and Principle 8 (conflicts of interest).

³ Consumer Panel submission to CMA retail banking market investigation: interim report, November 2015, available at https://www.fs-cp.org.uk/sites/default/files/fscp_response_cma_market_study.pdf

⁴ Royal Society for Public Health (2018), [Life on Debt Row](#)

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

Yes. Where firms have breached the rules, the FCA should exercise its powers to order firms to automatically pay redress to consumers.

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

Yes, we agree that firms should be required to charge for overdrafts by a single interest rate. Pricing using a single interest rate will help consumers compare the cost of arranged overdrafts between banks, and between overdrafts and other forms of consumer credit. In an environment where firms will be seeking to increase arranged overdraft charges, it is vital that they are not allowed to use complex pricing structures to confuse consumers or weaken competition by making it harder for consumers to compare different options.

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. 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 do 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 them 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.

These consumer behaviours 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" and to introduce tiered pricing structures.

In our view, the variety of pricing structures is not evidence of competition. Rather, it is 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 if the FCA needs more evidence for its proposal that firms must charge for overdrafts by a single interest rate, it should consider examining the Board papers and internal analysis which firms prepared as part of their overdraft pricing strategies.

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?

Yes. However, the nature of current accounts could mean that firms may be able to avoid displaying an APR when advertising the current account. To avoid this, it will be important

for the FCA to require firms to disclose the APR in any financial promotion for a current account which includes the potential for an overdraft to be available with that account.

The representative APR should also be disclosed on monthly statements and through online banking platforms and mobile apps.

Q6: Do you agree with our proposed guidance to help firms to calculate APR consistently?

No, we disagree with the inclusion of any interest-free overdraft in the calculation of the APR. This would result in multiple figures being displayed to the consumer with resulting confusion for consumers. We note that in the credit card market, proposals for a blended APR for introductory offers were rejected by the Treasury Select Committee and by regulators as it could lead to confusion⁵.

It is also important that firms are not able to use different interest calculation methods to obscure the true cost of overdrafts or to make comparisons between accounts difficult.

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?

Yes, we agree.

Q8: Do you agree that firms should report to the FCA information about their representative APR and that we should publish this information?

Yes, we agree that the FCA should publish this information and should make it clear that it will not be constrained in doing this by Section 348 of the Financial Services and Markets Act.

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?

Yes, we agree the cost disclosure should be provided. We suggest UK Finance should be required to consult consumer groups about the format and prominence of this disclosure before the FCA agrees to sanction a particular format or method.

Q10: Do you agree with our proposals for guidance for recovering costs via refused payment fees? If you disagree, please set out which costs should be excluded and why, and which costs should be included and why

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. It would be helpful for the FCA to 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. If banks cannot demonstrate that the level of fees charged relates to the "actual costs" incurred then the FCA should consider enforcement action and, require excess charges to

⁵ <https://publications.parliament.uk/pa/cm200304/cmselect/cmtreasy/125/125.pdf>

be automatically refunded to consumers. The FCA should also gather data on what “actual costs” banks are currently including and publish it.

We have the following amendments to the costs which we suggest should be added to the FCA guidance:

- Firms should only be able to include the marginal cost of sending a letter, text or email. In practice, the marginal cost of sending a text message or email is likely to be close to zero and this should be clarified by the FCA.
- Firms should only be allowed to include the marginal cost of customer service contact initiated by the customer over the phone, through digital channel and in branches which is a result of the missed payment, as long as these can be reasonably allocated to the activity of refusing payments according to an appropriate accounting methodology.
- Firms should not be allowed to include the cost of handling complaints caused by rejected payments as this would weaken incentives for firms to maintain high standards of customer service and efficient complaint handling. If firms did receive complaints due to misconduct and incompetence it would clearly be unfair to enable banks to recoup the costs of dealing with complaints from others who pay refused payment charges – especially as these charges are, on the available evidence, more likely to be paid by low-income consumers living in deprived communities.

We agree with the FCA that the following costs should be excluded:

- costs of refusing payments that fall outside the scope of the Payment Services Regulations;
- fraud detection and prevention;
- collection, recoveries and impairments;
- costs associated with advice to customers who need help to deal with their debts;
- bank statements;
- Financial Services Compensation Scheme levies;
- Financial Ombudsman Service general levy; and
- marketing.

The Panel also recommends that the FCA excludes the following costs:

- capital costs; and
- executive or managerial staff costs.

Q11: Do you agree with our proposed application of the rules?

Q12: Do you agree that firms should be given 6 months to comply with the proposed rules?

We answer Q11 and Q12 together.

Given the detriment caused by the current level of unarranged overdraft charges, the FCA should consider using its temporary product intervention powers to introduce the alignment of arranged and unarranged charges immediately.

Banks should be able to make changes to their overdraft charges to reduce the level of unarranged overdraft charges relatively quickly. We note that the FCA gave rent-to-own

companies just 4 weeks' notice of the introduction of a charge cap⁶. Given the greater detriment in this market we do not see any justification why banks should be allowed any longer than this to implement the new requirements. The Treasury Select Committee has also recommended the FCA should move forward with action on overdraft charges as quickly as it can⁷.

If the FCA decides not to do this then firms should be given no more than 3 months to comply with the proposed rules.

Q13: Do you have comments, observations or evidence on whether overdrafts provided to micro-business customers or products marketed to consumers as having the same function as an overdraft should be subject to similar rules to those proposed in this CP?

Overdrafts provided to micro-business customers have exactly the same function as overdrafts to personal customers and should be subject to the same rules. It is vital that banks are prevented from exploiting micro-business or SME customers with excessive overdraft charges and complex overdraft charging structures.

In the same way, products marketed to consumers as having the same function as an overdraft should also be subject to the same rules. In this context, it would be helpful for the FCA consider how Open Banking services may create additional detriment for consumers. For example, 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. There is a clear risk that without additional controls Open Banking services could allow firms to engage in aggressive collections activity, potentially pushing customers into an overdraft. Open Banking enabled overdraft services may be able to evade the requirement to conduct regular affordability checks that are triggered when extending a number of payday loans. The Panel encourages the FCA to be alive to this risk and to consider introducing a charge cap for Open Banking-enabled overdraft services to prevent regulatory arbitrage.

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

No, we do not believe that the FCA's proposals go far enough to prevent the harm from repeat use – particularly the harm caused to those in long-term financial difficulty.

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 for 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 take into account customers' other borrowing and their wider financial commitments. In addition, since overdrafts are a type of revolving

⁶ <https://www.fca.org.uk/publications/policy-statements/ps19-6-rent-own-price-cap-feedback-cp18-35-and-final-rules>

⁷ <https://publications.parliament.uk/pa/cm201719/cmselect/cmtreasy/565/565.pdf>, p.50

credit, 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.

Q15: Do you agree with the changes proposed in this chapter?

No comment.

Q16: Do you agree with our cost-benefit analysis?

We welcome the acknowledgement that transparency based solutions will only have a limited impact on some groups of consumers, particularly those vulnerable consumers.

We also welcome the fact that the FCA has included the cost to consumers' time of engaging with firms. However, we note that it has not considered or quantified the benefits to consumers' time or the reduced stress from no longer being subject to excessive unarranged overdraft charges and no longer having to contact the bank to complain about these charges.

We do not agree that the most likely outcome from the pricing interventions will be a "waterbed" effect where firms are able to increase charges to offset all of the reduction in revenue from unarranged overdraft charges. Part of the reason why firms may have been able to increase revenue from arranged overdrafts in the past has been by switching to a daily or monthly fee structure, which consumers find difficult to compare. The implementation of the single interest rate remedy is vital for limiting the ability of banks to offset the reduction in revenue by increasing arranged overdraft fees. However, it will be important for the FCA to monitor and report on changes in the market and the extent of any waterbed effect.

Yours sincerely,

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Chair, Financial Services Consumer Panel