Community Investment Coalition

Response to the FCA consultation CP14/10: Proposals for a price cap on high-cost short-term credit

A submission from the Community Investment Coalition (CIC)

CIC welcomes the FCA's consultation concerning the implementation of a price cap in the High Cost Short Term Credit ('HCSTC') market. However, we believe the FCA's proposals need considerable refinement to ensure consumers are adequately protected from becoming trapped into spirals of unaffordable debt. In particular, we are concerned that despite finding no evidence that payday loans benefit consumers (even those using the product on a short-term basis), and are clearly detrimental for those who become reliant on the product, the FCA's proposed cap only serves to legitimise much of the current, predatory, lending practice that is taking place. The proposed level of cap is simply too high to drive the level of change required in business models to ensure lenders take proper account of affordability and minimise the risk of trapping people in a cycle of default and/or continued product dependency with negative implications for the welfare of borrowers.

We would like to register our support for the consultation response submitted to the FCA by the Association of Chartered Certified Accountants (ACCA). That response supports the general structure of the cap proposed by the FCA but argues that the level of each of its component parts (the initial interest rate, default interest and charges, and the total cost cap) should be introduced at lower levels than the FCA suggests. ACCA's analysis makes a strong case for the FCA to amend its proposals to a 0.6% per day initial cost cap, £5 default fee cap and a cap on interest accrued post default of 0.03% per day, and a total cost cap of 75 per cent.

In addition to supporting the ACCA's position with regard to the level of the cap, we would like to make the following points:

- The definition of the HCSTC market is unduly restrictive. For example, we see no reason why home credit (door to door money lending) is not also to be subject to a price cap, and other requirements including rollover lending, when our experience indicates that they adopt similar predatory practices to payday lenders. It is now some eight years since the Competition Commission identified that home credit lenders were making excess profits and its remedies have clearly not proved successful in reducing levels of consumer detriment. We note that the FCA has ***indicated in this consultation that it will review its position with regards to home credit and we therefore ask that it now set out how it intends to do this, and over what timescale***? We consider that there is a need for a transparent investigation into how firms assess affordability in this sector, the levels of credit refinancing (rollover lending) taking place, and the levels of consumer detriment that result. In our view, there is a strong case for other forms of high cost credit, including rent to own, log book loans, overdrafts and credit cards, to be included within this investigation, and for the FCA to limit the extent to which credit is refinanced. The continued recycling of credit obligations increases the burden of debt on households considerably yet has little positive economic or social benefit. The case for a total cost of credit cap on all types of consumer credit should be explored in further detail.

- The reliance of the FCA on data sharing through credit reference agencies as the means to ensure more responsible lending behaviour (referenced in the consultation paper) is misguided. Experience from other countries (particularly the US) indicates that this does not eradicate the problem of borrowers using multiple payday lending firms either concurrently or as a means of refinancing existing payday loans. Only a real-time regulatory database of the type introduced in Florida has been proven to be effective in dealing with this problem, and we are not clear as to the FCA's reasons for rejecting this option. For example, it states in para 7.6 that Florida's rules include a maximum loan amount but in 7.7 that the state has no affordability requirement. Clearly the maximum loan amount in Florida has been set at a level which the state regulator feels to be an affordable amount for the types of household using the product. The FCA argues that 'individual affordability assessments' are more effective than the use of standard maximum amounts, which states in the US express either as flat rates or as percentages of the borrower's income. Our view of the evidence is that the UK approach, which relies on lenders making individualised affordability assessments, is one of our major problems because:
    - Lenders have a financial incentive to push the concept of affordability to its limit in order to trap people in dependent relationships;
    - There is a lack of clarity as to what is and what is not affordable when it comes to enforcement activity;
    - The process of assessing affordability in a highly individualised way would significantly increases the cost of lending small sums of money and that cost would be borne by consumers. As a result most lenders have their own

internal formulae for calculating what they consider to be affordable given basic income and household details. ***It would be better to abandon the notion of 'individual assessments' and take a clear, standardised approach. This would be cheaper to enforce even with the costs of maintaining a real-time regulatory database.***

We therefore call for the FCA to conduct and publish a detailed options appraisal of the two approaches within the next 12 months.

- We are also concerned about the FCA's approach to repeat lending. Whilst recognising that repeat loans are more profitable than loans made to new customers (para 5.73), the FCA does not propose any measures (beyond a faith in its enforcement of affordability requirements more generally) to remove the incentive for lenders to trap people in a dependent relationship. ***A cap could be constructed to do this by lowering the initial cost cap for repeat borrowers within a given period and we recommend that this be done.*** In addition, it is important for the FCA to secure a gap between the taking out of a loan and the repayment of previous borrowing otherwise borrowers will remain able to refinance one loan with another without this registering as a 'rollover'. They may do this with the same or different lenders. Again, without a real-time enforcement database of agreements it is difficult to see how this can be prevented. The total cost cap will be evaded as a result, and will be meaningless in practice for many repeat borrowers unless the FCA addresses this issue robustly in its final proposals.

- We support the FCA's proposal to include any brokerage, third party debt collection charges, and charges for ancillary services (para 5.70) to be included in the price cap. However, we are concerned that the consultation paper indicates that third party debt collection charges will only be included if they are included in the initial loan agreement. ***We would prefer a total cost cap to mean just that – that once (as ACCA propose) the principal plus 75 per cent has been paid then no further recourse can be made to the debtor by the original creditor or any subsequent third party for more. We would argue that this measure should be extended throughout the consumer credit market as a whole***.

- Likewise, with regard to the inclusion of insurance and other ancillary charges, we ***call for the FCA to investigate how these affect the total cost of credit paid by borrowers in the rent to own sector***, and how, had such a cap been in place at the time, it may have prevented the emergence of the endemic PPI abuse by banks and credit card companies.

- We support the FCA's proposals in respect of making agreements which breach the price cap unenforceable in their totality. Lenders need to be provided with a financial incentive to comply. ***We consider that any loan repayments made under an unenforceable agreement should be refunded to the borrower with the lender having no recourse to recovery of any of the principal lent***. That would provide the strongest possible incentive for lenders to ensure that they were in compliance with the cap;

- We recognise that there are complexities concerning enforcement relating to lenders who are established in other EU countries. We support the FCA's proposal to prevent any such lenders from using UK based debt collectors from enforcing payment of charges in excess of the price cap;

- We would, however, ***urge that the FCA ensure that borrowers are provided with a simple means of asserting that an agreement exceeds the price cap and, where this is the case, recovering any payments***. In our view this will require the Financial Ombudsman Service and the FCA to work together to ensure that individual complaints are quickly used to identify firms that are breaching the cap and for the FCA to order redress schemes to be put in place to aid all affected consumers whilst also considering the implications of a breach for the firm's ongoing permission to trade.

For more information

For more information, please contact Jennifer Tankard, Community Development Foundation (CDF) on 020 7812 5430 or jennifer.tankard@cdf.org.uk.

About the Community Investment Coalition (CIC)

CIC is a partnership of national organisations including financial providers, charities, trade associations and academic bodies. Our mission is to promote access to affordable finance for families, businesses and communities.

CIC campaigns for:

Increased transparency and public accountability of financial service providers to support consumer choice and allow effective intervention in under-served markets.

Increasing diversity of providers and choice for consumers in the financial services sector, with more providers offering a wider range of fair and affordable products to households, individuals, communities and businesses.

More innovation in the financial services sector so that affordable financial products are delivered accessibly to all communities.

Sustainable local economic growth with a greater share of locally generated income remaining within communities.

Improvements in financial literacy for all sections of the community.

We do this by:

- Collecting and sharing evidence and knowledge through research, conferences and dialogue;
- Campaigning for a regulatory system which helps not hinders community investment;
- Speaking with a unified voice on issues facing the sector; and
- Building the capacity of the Community Investment Sector through infrastructure and collaboration.

Partners include the following organisations:

The Centre for Responsible Credit (CfRC) is a dedicated unit established within the Centre for Economic and Social Inclusion to: monitor the development of credit markets; research models of responsible provision and promote policy responses which protect the long term interests of households.

The New Economics Foundation (nef) is an independent think-and-do tank that inspires and demonstrates real economic well-being. We aim to improve quality of life by promoting innovative solutions that challenge mainstream thinking on economic, environment and social issues. We work in partnership and put people and the planet first.

CCLA manages money for more charities than any other fund manager in the UK and we are owned by our not-for-profit clients. We engage with the banking sector every day on behalf of our charity and local authority clients, who are concerned with issues that may affect shareholder value, but also wish to see account taken of their ethical investment concerns. CCLA is ranked top manager of ethical and responsible investment funds in the UK by assets under management.

Local Trust delivers the Big Local programme with an investment of over £200m from the Big Lottery Fund. Big Local is happening in 150 communities across England over the next 15 years. It provides residents in each community with at least £1m and a range of other support and funding to develop ways of making their areas even better places to live.

CDFA's mission is to support the development of thriving and sustainable community development finance (CDFI) sector that provides finance for disadvantaged and underserved communities and, as a consequence, contribute to the increasing prosperity of these communities.

The Community Development Foundation (CDF) is a social enterprise passionate about helping communities. We have unique expertise in using community development to strengthen local voices, improve people's lives and create better places to live. Our vision is for successful lives in flourishing communities.