# FCA high-cost credit call for input

Citizens Advice response

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# Summary

## The regulation of high-cost short-term credit has been positive for consumers

Since the Financial Conduct Authority (FCA) introduced tougher regulations in the payday lending market, the number of people with unmanageable payday loan debts has more than halved. Problems seen by Citizens Advice have fallen from over 10,000 a quarter at their peak to just over 4,000 now.

That is partly because the market is different; there are fewer lenders and fewer customers. But it is also because the market is delivering better outcomes. Between January 2015 and April 2016 the number of loans which incurred default charges halved, from 16% to 8%, and the proportion in arrears for more than seven days fell by a quarter, from 16% to 12%. Consumers are also paying less to borrow. In 2014, the average consumer paid £100 in interest and charges to their payday lender. They now pay £60, despite the average loan amount remaining relatively stable at £250.

## That has not led to equal detriment in other areas

Tougher regulation of high-cost short-term credit (HCSTC) has not led to negative unintended consequences:

- ***Access to credit*** - We found around 8% of customers who had previously used a payday loan had been declined following the cap. Even for them that did not mean they could no longer access credit.
    - Most consumers who are declined use other sources of credit - nearly half use credit cards and a third use overdrafts. HCSTC is just one credit option.
    - The FCA found that when applicants were declined, 43% decided not to borrow at all, 25% borrowed from friends and family, 6% borrowed from another payday lender and just 4% borrowed in another way.
    - Our research found that of those who are declined for a loan, just over a third said they felt they were worse off financially as a result. Only a quarter said it had a negative impact on their lives.
    - The FCA research shows that those who take out a HCST loan are in a worse financial position 12 months later, while those who are declined are not.
- ***Waterbed effect -*** Citizens Advice data does not show evidence that the fall in payday debt issues lead to a growth of problems in other markets. Since their peak, the number of issues relating to payday lending have fallen by over half. At the same time, issues across other high-cost credit areas have fallen by over 30%. The changes to the payday loan market have been overall net-positive for consumers.
- ***Household bills -*** Although household arrears have recently increased, this has been driven primarily by council tax arrears and the introduction of council tax support - a year before the regulation of high-cost credit. There is little

evidence to suggest household finances have worsened as a result of the HCSTC cap.
- ***Loan sharks*** - Analysis of Citizens Advice case notes found that the number of problems caused by loan shark debts had remained constant since  April 2014. That is supported by the FCA and Illegal Money Lending Team.

## But there are ongoing problems in other high-cost credit markets

The starker impact of the regulation has been to highlight the ongoing problems in markets that are similar to payday lending - but have not received the same regulatory attention.

Across high-cost credit markets there are ongoing issues of affordability and of spiralling debt. In the doorstep loan market a quarter of people fall into arrears and a third of consumers do so within the rent to own sector. Those people often miss payments on priority bills or borrow more in order to make their high-cost credit payments.

More specifically, each high-cost credit market presents unique problems. Citizens Advice has conducted recent research to look at the causes of problem debt in the doorstep loan, rent to own, guarantor, and logbook loan markets.

- ***Doorstep loans -*** Citizens Advice helped 23,600 people with doorstep loan debt issues last year. Doorstep lenders pressure people into taking loans by cold-calling their homes, pressuring people to make repayments and encouraging refinancing when a person is in arrears.
- ***Rent to own credit -*** Citizens Advice helped people with 11,500 hire purchase issues last year. Rent to own companies inflate prices of goods and then add on further costs by charging high prices for compulsory aftercare services.
- ***Guarantor loans -*** Citizens Advice helped more than 2,000 people with guarantor loan debt issues last year. We helped twice as many guarantors as borrowers. Guarantors are often not aware of their liability and some don't receive any notice before they are required to make payments.
- ***Logbook loans -*** Citizens Advice helped people with over 700 logbook loan debt issues last year. Logbook loans are antiquated and complex and put borrowers in a vulnerable position with little protection from repossession of their goods.
- ***Unarranged overdrafts*** - Citizens Advice helped people with 50,000 issues related to overdrafts last year. Unarranged overdraft fees lead to spiralling and persistent debt and too little is done to help people avoid fees and charges.

## What can be done?

There are specific remedies needed in each market, however the FCA should build on its success in the payday loans market by extending the total cost cap across all forms of high-cost credit. At the very least, the FCA should remove the current exceptions for doorstep and logbook lenders so that no customer of these high-cost credit products pays back more than double the amount borrowed. We would like the FCA to go

further, however, and explore how even lower caps could work in different markets based on operating costs, risks and market dynamics.

The FCA should also address the current issues around affordability checks across high-cost credit markets by strengthening its guidance into rules for high-cost lenders. As a minimum, high-cost lenders should be required to see proof of income and expenditure before lending.

## Citizens Advice Reports

This call for input response refers previous research by Citizens Advice:

- Evidence on bill of sale consumer lending (2014)
- A problem shared? (2015)
- Hire purchase: Higher prices (2016)
- Payday loans after the cap (2016)
- Payday loans: An improved market? (2016)
- Debt on your doorstep (2017)
- Catalogue customers hit hard for missing interest free deadlines (21 December 2016)

# About Citizens Advice

Citizens Advice provides free, confidential and independent advice to help people overcome their problems. We are a voice for our clients and consumers on the issues that matter to them.

We helped 2.7 million people face to face, over the phone, by email and webchat in 2015-16. There were also 36 million visits to our online advice pages. We help with everything from money issues to problems at work, housing to consumer rights.

Sometimes a person has more than one problem, and often they are linked. We tackle issues in the round making sure people get all of the support they need.

We helped 400,000 with debt issues last year and 285,000 people with financial services advice issues, including 120,000 with financial capability.

We delivered 70,000 Pension Wise guidance sessions

There were 7.7 million visits to our debt and financial services website pages.

# Part 1 - High-cost credit: wider issues

## Q1: Which high-cost products do you think our review should focus on and do you think a more consistent approach to high-cost products is feasible or desirable?

The primary products that cause people to need debt advice from Citizens Advice are doorstep loans, rent to own credit, catalogue lending, guarantor loans, logbook loans, and pawnbroking - as well as payday loans. The approach of the review to consider all high-cost credit products together with HCST credit is the right one.

Those products are similar not just because they cause high levels of consumer detriment (see response to question 2) but because of their high cost. High-cost credit markets typically provide credit at an interest rate of over 50% and up to 1,500% APR. That cost reflects the business costs of lenders, the riskiness of the borrowing and the lower demand pressure exerted by users of high-cost credit.

The second reason the review should look at the credit markets together is because they are used by similar groups of people. Demographic analysis of the Wealth and Assets Survey shows that in all the markets listed above, customers are more likely than average to be in the poorest fifth of the population, have dependent children, rent, and have a long-term health problem or disability. The table below sets out the results.

**Figure 1: Demographics of doorstep and rent to own credit consumers**

| | Poorest fifth | Dependent children | Renters | Disability |
|---|---|---|---|---|
| All adults | **20** | **27** | **28** | **18** |
| Doorstep | 50 | 55 | 90 | 38 |
| Rent to own | 45 | 55 | 77 | 43 |
| Catalogue | X[1] | 50 | 82 | 46 |
| Payday loan | X | 43 | 74 | 36 |
| Guarantor loan | X | 34 | 48 | 35 |
| Logbook loan | X | 53 | 78 | 36 |
| Pawnbroker | X | 46 | 85 | 43 |

Source: Citizens Advice Analysis of the Wealth and Assets Survey

[1] Indicates a lack of data.

## Q2: To what extent is there detriment from high-cost credit products (other than HCSTC)?

Citizens Advice helped people with around 100,000 issues related to high-cost credit last year. The causes of those issues is recorded by advisers for each credit type. The tables below sets out the number of issues we helped with in each market last year.

### Figure 2: Total debt issues

| Debt | Number of issues |
|---|---|
| Catalogue | 48,061 |
| Doorstep | 23,600 clients[2] |
| Payday | 16,809 |
| Hire purchase | 12,333 |
| Guarantor | 2,153 |
| Logbook | 717 |
| Pawnbroker | 287 |

### Figure 3: Causes of each type of debt issue as a percentage of total issues for each high-cost debt[3]

| Cause | Catalogue | Payday | Hire purchase | Logbook | Guarantor |
|---|---|---|---|---|---|
| Gateway | 4 | 4 | 6 | 5 | 5 |
| Liability for debt | 16 | 14 | 16 | 17 | |
| Liability for debt - borrower | | | | | 11 |
| Liability for debt - guarantor | | | | | 35 |
| Dealing with debt repayments | 68 | 72 | 52 | 46 | |
| Dealing with debt repayments - borrower | | | | | 14 |
| Dealing with debt repayments - guarantor | | | | | 19 |
| Creditor harassment | 2 | 2 | 4 | 4 | 3 |
| Court claim for debt | 5 | 3 | 4 | 16 | |
| Enforcement by bailiffs | 2 | | 10 | 4 | 11 |
| Enforcement - charging order & order for sale | 0 | | | | |
| Other methods of enforcement | 1 | | | | |
| Use of continuous payment authorities | | 2 | | | |
| Complaints and redress | 1 | 1 | 1 | 3 | 2 |
| Default charges | 1 | 1 | 2 | 3 | 1 |
| Termination | | | 5 | | |
| Third party purchasers | | | | 1 | |
| Total | 100 | 100 | 100 | 100 | 100 |

[2] We do not currently record advice issue statistics for doorstep loans. This is an estimate based on the number of clients with doorstep debts. Full methodology here.

[3] These figures come from gateway advice sessions run by Citizens Advice. These sessions involve a short consultation with a client where their needs are assessed and they are either signposted to another service or provided with an appointment based on their needs.

**Affordability**
The most common cause of high cost debt issues is around clients' abilities to afford debt repayments. There are different issues which cause problems for different types of debt. One common cause across high-cost markets is that affordability is not checked thoroughly enough.

In the doorstep lending market, our analysis of detailed case notes shows that Citizens Advice advisers see cases which demonstrate that adequate affordability checks are not being carried out. The lack of adequate affordability checks is particularly clear where doorstep loan customers who have struggled with repayments are able to take out new loans, as repeat borrowing and refinancing loans. In our analysis, one in three clients had taken out multiple doorstep loans.[4]

In the rent to own market our survey of nearly 2,000 customers indicated a high proportion of customers are struggling to keep up with rent to own repayments.[5] Half of customers surveyed by Citizens Advice had taken out another form of borrowing at some stage to assist with rent to own repayments, one third had fallen behind with their repayments and a quarter had stopped paying other bills. One in five customers were spending over a fifth of their income on rent to own repayments.

And in our analysis of cases involving logbook loans, 10% involved cases where a reasonable assessment of affordability did not appear to have been undertaken and vulnerable consumers were often offered logbook loans which they clearly would not be able to pay back on time.[6]

There is also an ongoing issue of poor affordability checks in the payday lending market. When we surveyed clients, those who could recall having to provide information about their income and expenditure were half as likely to have fallen into arrears on their payday loan.[7] For more detail please see the response to Question 10.

**Detriment in specific markets**
To better understand the causes of detriment and problem debt in each market, Citizens Advice has conducted a number of additional pieces of research using internal and external data sources. The individual research reports give more detail.

[4] This figure comes from analysis of over 4,000 clients in our electronic case recording module for the first two quarters of 2016/17.
[5] Citizens Advice, (2016) Hire purchase: Higher prices.
[6] Citizens Advice, (2014) Evidence on bill of sale consumer lending.
[7] Citizens Advice, (2016) Payday loans after the cap.

## Doorstep lending (home credit)[8]

In the doorstep lending market, around 25% of customers fall behind on payment. There are two major causes of consumer detriment in addition to a lack of proper affordability checks; pressure sales and intimidating collection practices.

- **Pressure sales** - Citizens Advice advisers see large numbers of cases where clients have not initially sought out a doorstep loan themselves. In our analysis, more than 1 in 10 loans were initiated by a doorstep lending agent rather than the client.

  It is also common for doorstep loan customers to take out repeat loans. Rather than offering repayment plans to customers who are struggling with an existing loan, some lending agents pressure customers to take out a new loan to refinance their existing debt. Lending agents may benefit from keeping customers in a cycle of debt, as reliable customers offer a steady stream of payments, and commission, and agents may also receive bonuses for meeting sales targets.[9] The offer of an immediate cash loan at their doorstep can lead some customers to make poor financial decisions.

- **Intimidating collection practices** - Citizens Advice advisers see repeated instances of poor collection practices by lending agents. This includes lending agents threatening to tell clients' families or neighbours about debts, harassing clients for repayments in public locations, and demanding payments by family members or friends.[10]

  This aggressive form of debt collection often means doorstep loan customers miss payments on priority debts. Multiple clients seen by Citizens Advice with a doorstep loan fell behind on council tax payments or their energy bills in order to repay their loan. Around 10% of clients in our analysis indicated they were unable to afford food as a result of prioritising their debt repayments.

  In the most extreme instances, aggressive collection practices involve families going through bereavement and ill health. The case below illustrates one instance seen by an adviser.

  *A single parent was £2,500 in debt. On the same day that his 9 year old son died, the lending agent came to his home and demanded payment. Despite having the situation explained, the agent refused to leave and escorted a family member to an ATM to withdraw cash and make a £250 payment.*

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[8] Citizens Advice, (2017) Debt on your doorstep.
[9] Commissions for one company were described as being between £6 and £9 per £100 collected. BBC One Panorama, 'Undercover: Debt on the Doorstep' (7 October 2012).
[10] In contravention of CONC 7.9.6R.

## Rent to own[11]

Rent to own debts regularly push customers into financial difficulties. In our survey of nearly 2,000 rent to own customers:

- Half had taken out other debts to keep up with rent to own repayments; 28% had borrowed from a doorstep lender, 24% had used a credit card and 20% had taken out a payday loan.
- A third said they had missed one or more payments with their rent to own company and 7% of those who missed payments had their goods repossessed.
- A quarter were unable to pay other bills, such as their council tax, rent, or television licence after falling behind on their rent to own payments.

Those debt issues are particularly concerning in the rent to own sector for a number of reasons:

- The debts are often large - in 2014/15, the average rent to own debt of a client who came to Citizens Advice for help was £1,309. That was nearly 2.5 times more the average payday loan debt of £532.
- People regularly have multiple debt issues. Last year 81% of people needing help with hire purchase debt had at least one other debt issue.
- Users of rent to own products are also more likely to be vulnerable than the average population.

There are three primary reasons many rent to own consumers struggle to pay their rent to own debts:

- Rent to own shops are expensive. Due to a combination of inflated prices, add-on charges and interest rates of nearly 100%, rent to own consumers regularly pay two or three times more than consumers who can pay up front.
- Consumers experience poor treatment when they do fall into arrears. Seven per cent have their goods repossessed - even when they have already paid a significant sum for their products.
- The cost of buying from rent to own shops is unclear. Add-on charges and inflated prices make it difficult for consumers to compare prices across providers and calculate how much they are paying for the product itself.

## Guarantor loans[12]

Guarantor loans present more complex issues due to the shared and contingent nature of the liability. Two particular issues stood out in our analysis.

- **Guarantors are often not aware of their liability** - Guarantors are twice as likely to come to Citizens Advice for help and in detailed analysis of cases the most common issue we saw was uncertainty around the responsibilities of guarantors. Overall, 25% of issues involving a guarantor loan involved some misunderstanding of what guarantors were responsible for and 43% of guarantors who sought the help of Citizens Advice raised an issue concerning the extent of their responsibilities.

[11] Citizens Advice, (2016) Hire purchase: Higher prices.
[12] Citizens Advice, (2015) A problem shared?.

The speed at which a guarantor can take on liability for a loan and transfer the balance to the borrower means, as well as the complexity of the product and the difficulty consumers have in understanding what they are agreeing to, guarantors do not have a cooling off period as provided by the Consumer Credit Act.

- **Requests for payment** - The second most common cause of problems was a lack of forbearance shown to borrowers or guarantors, meaning that guarantors were asked to make payments with little notice and a lack of flexibility - particularly in relation to the contingent and uncertain nature of their liability. To some extent, the new guidance meaning guarantors must be given notice and a 'reasonable period' in which to make a payment is an improvement. The implementation of a reasonable period, and whether firms go beyond the 5 days notice that is recommended, will determine the impact of that regulation.

**Logbook**[13]

Like guarantor loans, logbook loans are complex products and so cause detriment for a number of reasons. In our research, we found three main causes of that detriment:

- **Lack of consumer protection** - Because lenders take direct ownership of the customer's vehicle there is little incentive on firms to lend or collect debts responsibly. For instance, there is no onus on the lender to negotiate when the consumer gets into payment difficulties because they can just seize the asset.
- **A lack of understanding** - As the Bill of Sale Acts originate from the Victorian period, the language used in the credit documentation is often outdated and unclear. This can lead to consumers not understanding the terms and conditions of the loan - for example, not always realising that they no longer own the property on which the loan is secured. It can also result in consumers not understanding that they could lose their car if they do not keep up repayments. Understanding the risk is essential in order to make an informed choice about taking out the loan.
- **Third party purchasers -** Another feature of logbook lending is that there is also no protection for third-party purchasers, where a person buys a second hand car without knowing it is subject to an outstanding logbook loan. This leaves the person with few options other than paying back someone else's debt, losing their car or going to court.

[13] Citizens Advice, (2014) Evidence on bill of sale consumer lending.

## Q3: Where there is detriment, do you consider that it arises from matters not addressed by our rules, or is it mainly caused by firms failing to comply with the rules?

Citizens Advice helps people experiencing detriment across a number of high cost credit products both as a result of firms failing to comply with rules and because some rules are not sufficiently comprehensive.

**Affordability**
As set out above, there is a problem across high-cost markets of a lack of thorough affordability checks. Both the outcomes for consumers, and the experience of consumers in different markets shows that the current rules and guidance on creditworthiness are not protecting high-cost credit consumers. We propose improvements to the rules on creditworthiness in response to Question 4.

In addition to the broader issue of affordability, which arises because of a lack of clarity in the guidance, there are specific problems in different markets that are the result of both conduct and regulatory shortcomings.

**Doorstep lending**
**Pressure sales -** Citizens Advice analysis shows that there is severe detriment caused by the high pressure sales tactics of lending agents. These may operate against the guidance on General Principle 6 - to pay due regard to the interests of customers and treat them fairly - through targeting of vulnerable customers and pressure sales techniques.[14] In other markets, such as the energy sector, door-to-door sales have been discouraged by regulators.[15] ***The FCA should investigate and address the inevitable detriment of doorstep credit sales.***

**Lack of forbearance and aggressive collection -** In addition to irresponsible lending practices, we found examples of lending agents who were not complying with forbearance requirements. Some clients seen by Citizens Advice stated that their lending agent refused to negotiate a payment plan and instead pressured them to refinance with a new doorstep loan. In part, we attribute this to a commission model which rewards collecting repayments or issuing new loans and therefore discourages lending agents from demonstrating forbearance.

We found that some lending agents went to extreme lengths to collect repayments and exhibited behaviour in breach of FCA's Consumer Credit Sourcebook (CONC) rules and guidance. This included visiting clients in hospitals or care homes despite requests to the contrary (7.9.14R(2) / 7.9.15G), agents demanding repayment from friends or family (7.5.2R), agents threatening to tell a customer's friends, family or neighbours about their debt (7.9.6R), agents loudly demanding repayment in public

[14] CONC 2.2.2G (1) and (2).
[15] CMA, (2016) Energy Investigation final report, 362 [8.72].

places (7.6.7R) and agents refusing to leave a customer's premises without repayment (7.9.14R).

It is difficult to assess the extent to which this occurs across the whole market due to the independent manner in which lending agents operate, however it is clear that the FCA rules for responsible collecting practices are being ignored by some lending agents. ***Citizens Advice would like to see the FCA introduce stronger requirements upon firms to train doorstep lending agents on their rights and responsibilities.***

**Rent to Own**

Rent to own companies also demonstrated poor forbearance practices. Our survey indicated that 90% of customers who were struggling to make repayments were not offered a payment holiday and more than a third were unable to agree to a new repayment plan. Some customers also indicated they experienced harassment from agents of rent to own companies, including threatening phone calls and repeated home visits at unreasonable hours.

Rent to own consumers also get into difficulties due to the high price paid for compulsory add-on products - such as Brighthouse's aftercare. ***The FCA should introduce competition for add-on products in the rent to own sector by requiring rent to own lenders to separate add-on costs.***

**Guarantor loans**

Despite new requirements for an 'adequate explanation' to be provided, we continue to see cases of guarantors who do not understand the circumstances of the loan and were signed up as guarantor by phone or email without thorough understanding. In other cases, proper affordability checks are not being conducted on guarantors, who may find themselves unable to cover the loan when the borrower cannot make payments. ***The FCA should require guarantors to sign a physical agreement before becoming liable for a loan.*** That would not only give guarantors a better chance of appreciating their responsibility but would give guarantors a longer period of consideration - in the absence of a cooling off period under the Consumer Credit Act.

**Catalogue debts**

A Citizens Advice analysis of catalogue debt cases indicated that customers were taking on 'buy now pay later deals' they did not fully understand.[16] That can cause detriment in particular when at the end of an 'interest free' period high interest rates were backdated on items which they had paid a substantial amount of repayments towards. Our analysis indicated that many clients are not aware that an interest free buy now pay later payment plan will normally back-date interest on the full cost of the item even if most repayments have been made. ***Although this lack of understanding may not arise because of FCA rule breaches, we would welcome FCA initiatives to introduce clarity around interest free advertising requirements.***

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[16] Citizens Advice, (21 December 2016) *Catalogue customers hit hard for missing interest free deadlines*.

## Q4: If there is detriment arising from matters not addressed by our rules, what sort of interventions should we consider? What would be the impact?

Citizens Advice would welcome the development of new rules to address current shortcomings. As highlighted above, one issue that is common across high-cost markets is a lack of robust affordability checks. ***We would like to see guidance on affordability checks strengthened into rules for high cost borrowing.*** At a minimum, where a customer is taking on high cost credit which is likely to result in significant debt, affordability checks should require proof of income and expenditure.

There could also be improvements to guidance under CONC 5.2.3G to require better regard to a client's *financial position*, *commitments* and *vulnerability*. A sub-clause should be added which clarifies how these factors are to be assessed with consideration and assessment of the customer's personal circumstances - whether the customer has dependents, caring responsibilities or a disability and whether the customer is in receipt of benefit payments for these. Having regard to these factors would encourage more responsible assessments of a customer's creditworthiness and the impact that high cost debt may have on the customer. We believe that if these factors were genuinely considered, there would be lower rates of unsuitable loans being provided to vulnerable people.

Where there are specific issues that are not addressed by rules - possible remedies are set out in the response to Question 3.

## Q5: Should some of the HCSTC protections be applied more widely? What would be the impact on the cost of or access to credit?

***The total cost cap should be extended to all forms of high cost credit.*** Across all high cost credit sectors, there are similar rates of vulnerability and experiences of clients who struggle with unaffordable debt. A price cap on all high cost credit would provide better certainty to customers of high cost credit and prevent debts from becoming unmanageable.

At the very least that should mean the current exclusions under (e)(ii) of the FCA's definition of high cost credit should be brought under the cap. In particular, doorstep lending and bills of sale and the detriment caused by revolving credit should be addressed separately.

However, the FCA should also consider what effective price caps would look like across a range of markets. Extending the cap to other markets would provide a simple and enforceable consumer protection which would largely act as a safeguard tariff, protecting consumers at the margins and where credit agreements have unforeseen outcomes.

***The FCA should also extend refinancing rules for payday loans to cover other loans within the high cost credit market***, in particular doorstep lending. In this sector we uncovered repeat instances of lending agents encouraging customers struggling with debt to refinance existing loans without demonstrating adequate forbearance or rescheduling payment plans. This behaviour could be better moderated if stronger refinancing rules were introduced. We would also welcome strengthening guidance on refinancing into rules - such as the guidance which discourages unsustainable or otherwise harmful refinancing (6.7.21-22G).

We would like to see the limit on the number of times a loan can be refinanced to be extended across other forms of high cost credit (6.7.23R). Further, the requirements upon payday lenders who are refinancing a loan to provide a customer with information regarding refinancing and debt advice should be extended across the high cost credit market (6.7.20R). This would ensure better regulatory consistency across all forms of high cost credit.

To encourage doorstep lending customers to consider whether a doorstep loan is in their best financial interests, we would like to see the FCA introduce a requirement for doorstep lending agents to disclose that they operate on a commission basis. Citizens Advice would welcome the extension of CONC 4.5.3 and 4.5.4 - on compulsory disclosure of commission by credit brokers - to cover doorstep lending agents.

**The impact on access to credit**
In terms of access to credit, many of the concerns around the cap restricting access to credit have not materialised. While  around 8% of customers who had previously used a payday loan had been declined following the cap, that did not mean they could no longer access credit.

- Most consumers who are declined use other sources of credit - nearly half use credit cards, a third use overdrafts. HCST credit is just one option.
- The FCA found that when people were declined 43% decided not to borrow at all, 25% borrowed from friends and family, 6% borrowed from another payday lender and just 4% borrowed in another way.
- Our research found that of those who are declined for a loan, just over a third said they felt they were worse off financially as a result and only a quarter said it had a negative impact on their lives.

In the other markets detailed above, the impact would likely be more marginal still. For instance in the doorstep market none of the major lenders offer credit agreements which require payments of more than twice the original principal, similarly in the rent to own and guarantor loans markets.

The effects of a cap would be two fold. It would offer consumers protection from spiralling costs and extreme debt problems. It would also provide a simple safety-net to consumers that is easy to understand and can be enforced by even a moderately engaged consumer would offer significant protection while only marginally affecting the business models of the majority of lenders.

More generally, concerns around access to credit are overblown due to the nature of demand in the high-cost credit market. Because consumers don’t provide sufficient demand side pressure on firms - they are insensitive to price changes - firms are able to charge very high prices. Since the regulation of high-cost credit the average price of a £250 loan has fallen from £100 to £60. Short-term credit is still viable, but consumers have been protected from very high prices.

The price of a loan does not reflect the cost of providing it, but what someone will pay for it. A price cap adds protection where consumers have weak bargaining power or are likely to make adverse selections, whether that is due to a lack of information, the behaviours and capabilities of the consumer, or the situation the consumer finds themselves in.

A further implication of that is, even where a cap did reduce access to credit, if it encourages market competition and improves the functioning of the market for consumers there would be a good case for the FCA to take action. Many high-cost markets are effectively broken - a third of rent to own consumers and a quarter of doorstep lending consumers fall behind on payments. If limiting the detriment of high-cost credit leads to a smaller market, it will have done so while fulfilling both the aims of better consumer protection and market integrity. Sacrificing consumer protection on the grounds of maintaining easier access to credit is a social policy

decision the FCA should be reluctant to make. Broader access to credit should not be valued above high levels of consumer detriment.

Introducing a cap on the market also provides an opportunity for the FCA to signpost consumers to free impartial debt advice. Rules on payday loan refinancing require lenders to provide consumers with an information sheet which directs them to free debt advice and asks them to think about their financial situation. Earlier access to advice would help consumers to address their debt problems and avoid getting into further debt. This would likely increase demand upon debt advice services, which may justify consultation on the debt advice levy.

# Part 2 - Overdrafts

## Q6: To what extent do you think overdrafts are a substitute, or alternative, for other high-cost credit products?

FCA research identified that where people used - or tried to use - high-cost credit, 10% of their debts were overdraft debts. We also know that consumers who get into financial difficulties as a result of using HCST credit are likely to take on additional debt through using overdrafts. For example, nearly 1 in 10 rent to own consumers who gets in to financial difficulties uses an overdraft to make payments.[17]

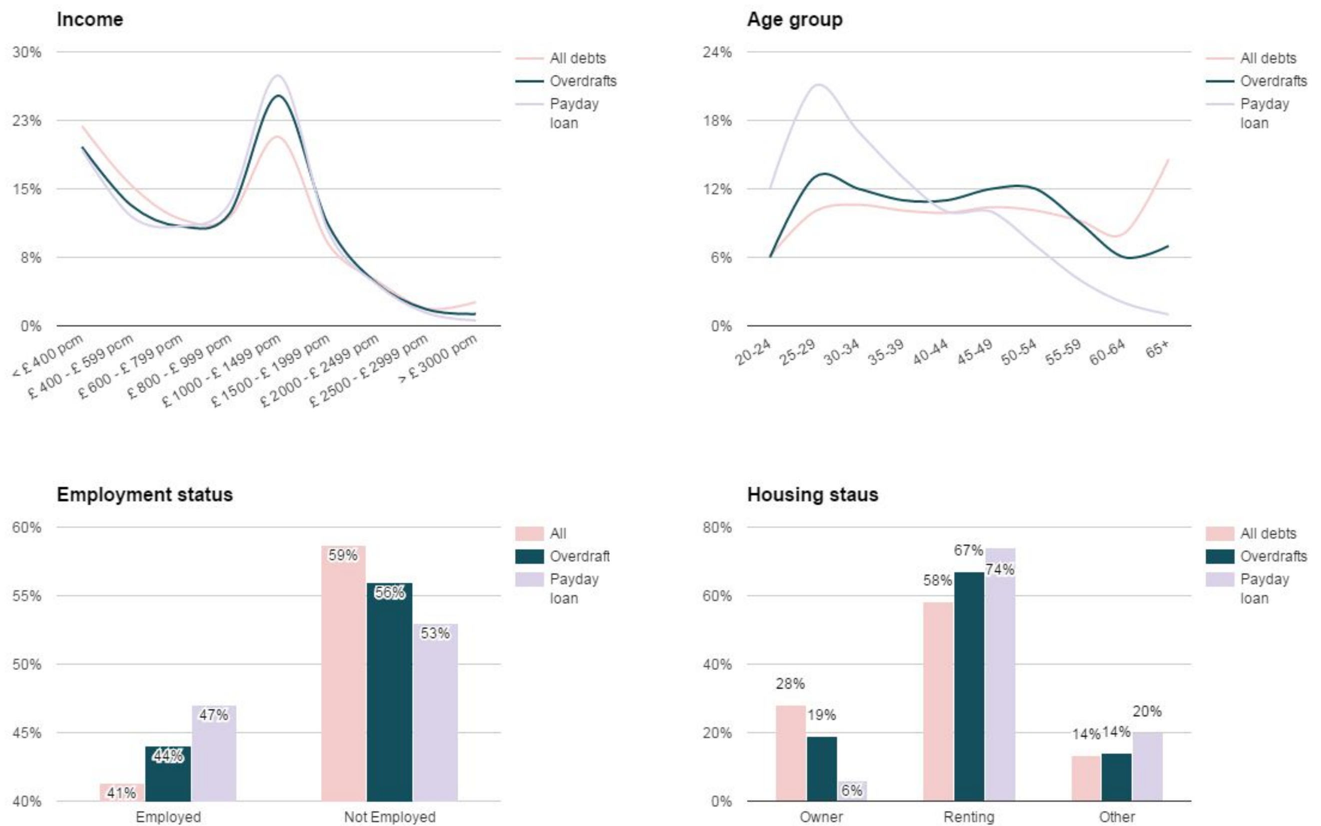
So there is some degree of overlap and a small amount of substitution between high-cost credit and overdraft use.

The fact that those who are struggling with high-cost credit payments are able to rely on an overdraft highlights a possible problem in that market. It might suggest that people who are using HCST credit already have an overdraft facility, but choose to use different types of credit for specific circumstances. It might also highlight that for some consumers getting an overdraft is perceived as easy to access or last resort credit.

Looking at the types of people who have debt issues and come to Citizens Advice shows that those with overdraft debt issues and HCST debt issues are more similar when compared with the larger cohort of clients we provide debt advice to. They are more likely to live in rented accommodation and to have an income of more than £1,000 a month. They are also more likely to be young, though the overdraft profile is more similar to the average debt client than a payday loan debt client. The charts below illustrate those relationships.

[17] Citizens Advice, (2016) Hire purchase: Higher prices.

## Overdraft and payday loan debt demographics compared with all debt clients




Source: Citizens Advice

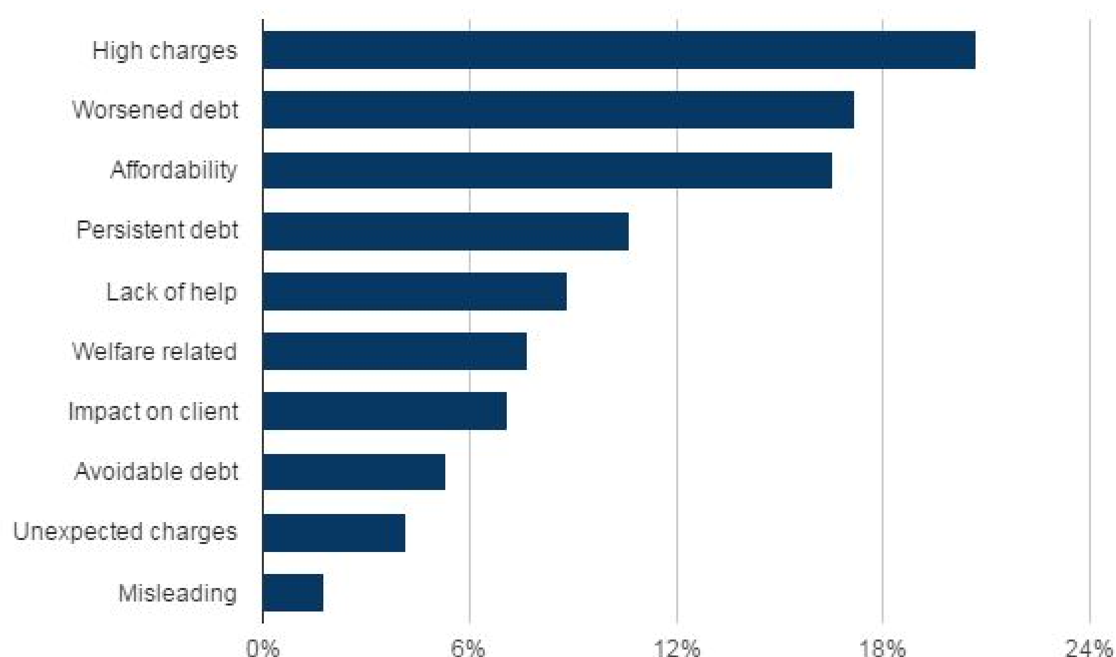
To some degree, whether consumers use overdrafts in a similar way to the way they use high cost credit is less important than the fact that overdraft consumers, particularly users of unarranged overdrafts, suffer similar detriment to people who take on unmanageable high-cost credit. People take on debts they can't afford and their debt often spirals and becomes unmanageable in the long term. More specifically, overdraft users generally, and unarranged overdraft users more specifically, often use that credit in ways that it was not designed. Just as payday loans lead to poor outcomes if they are used over a long period of time, multiple uses of unarranged overdrafts, or long-term overdrafts are not the intended use of a revolving credit facility and so lead to poor outcomes.

## Q7: What do you think are the key issues the FCA should consider on arranged and unarranged overdrafts respectively?

Citizens Advice helped people with 50,000 issues related to overdrafts last year. The issues are categorised according to what caused the debt issue. The most common cause of problem identified by advisers was dealing with repayments - 67% of issues, 14% were about debt liability, and 4% about overdraft fees and charges. The 'dealing with repayments' issue is normally used for general affordability issues.

Looking more closely at the evidence submitted by advisers where the cases they see have possible social policy implications, we can see what the common causes of issues are. We analysed 100 evidence forms submitted by advisers, the table below illustrates the frequency of each issue issue identified by advisers.

**Types of overdraft debt issues seen by Citizens Advice advisers**




Source: Citizens Advice

Of the issues we analysed, 42 were concerning unarranged overdrafts, 19 arranged overdrafts and 39 were unknown.

A particular concern is where unarranged overdraft charges lead to spiralling and persistent debt. For instance, in one case which illustrates that problem:

> *A client had an overdraft which exceeded her agreed limit. She was charged £60 a month in overdraft charges and over a year was charged a total of £780. That pushed her further into debt and caused financial hardship. The client was not in a position to pay the charges and bring down the*

*outstanding debt but the bank refused to switch the overdraft to a loan or freeze the charges.*

There is also an issue around firms failing to help people once they are in persistent debt. The CMA have mandated banks and the FCA to take steps to help people avoid unmanageable debts in the first instance. A particular problem, identified by the CMA, is that there is an incentive for banks to lend to consumers who struggle to afford their overdraft. The CMA showed that customers who pay unarranged overdraft fees, or who are in their overdraft for long periods of time, are more profitable than those who don't use their overdraft. Introducing incentives for banks to help people avoid overdraft charges, rather than rules to make them, would be a more effective intervention.

## Q8: What measures could be taken to address these and what would be the risks and benefits?

On unarranged overdraft charges, there is a strong case to go further than the CMA's recommendation and implement a fixed monthly maximum charge. Unarranged overdraft charges are not subject to ordinary consumer decision making. They are punitive prices - which don't reflect the cost of delivery - and take advantage of consumer's approach to risk and forecasting. We know that consumers do not accurately forecast how they will use a services and tend to be optimistic.

As the the CMA identified, overdraft users who suffer the most detriment from high overdraft fees are the least engaged with their product and least likely to switch. Around half of unarranged overdraft users were unaware they had gone into overdraft. This group also tends to have lower levels of income or education than arranged overdraft users. In Great Britain, those customers heavily using unarranged overdrafts for over 8 days a month could save upwards of £540 a year if they switched personal current accounts. However, overdraft charges are difficult to compare due to their complexity, the multiplicity of the charging structures and customers lack' of awareness over their own usage.[18]

Further information and transparency about the charges for overdrafts is unlikely to be effective because consumers are unlikely to choose their current account based on an event that they don't foresee.

[18] CMA, (2016) Energy Investigation final report, x-xviii.

# Part 3 - The current state of the HCSTC market

**Q9: Please provide evidence and/or views on:**

- **the reasons for the substantial reduction in applications from consumers for HCSTC and the reduction in acceptance rates by firms**
- **whether this decline will continue, plateau, or lending will increase**
- **the impact of the price cap on the viability of HCSTC and how this might differ for online and high-street, and**
- **the impact on loan duration and product development more generally of the structure and level of the price cap**

The significant reduction in debt problems caused by payday lenders is partly the result of a changing market as well as the fact the market is now driving better outcomes for consumers. The reduction in applications by consumers may be the result of a wide range of factors. In terms of changes in the market itself, the initial price cap, total cost cap, cap on defaults and limit on rollovers mean that firms are likely to have lower profit margins and less capacity to absorb losses. The resulting exit from the market of a large number of firms is likely to have been an important reason why applications have fallen. Our research in March 2016 found that at least 38% of firms that had offered payday loans before the introduction of the cap. Firms that are operating are less likely to seek out risky customers.[19]

The reduced risk profile for firms is likely to have had a more dramatic impact on the acceptance rate of applicants for firms and the 10% of customers who had previously used payday loans and been declined when they had applied following the introduction of the price cap.

The number of  payday debt issues we see has now leveled off. There is currently no indication of an increasing rate of reduction in issues. That suggests that the market is now steady. That reflects a more mature market where firms are able to operate sustainable business models while driving positive outcomes for larger proportions of their customers.

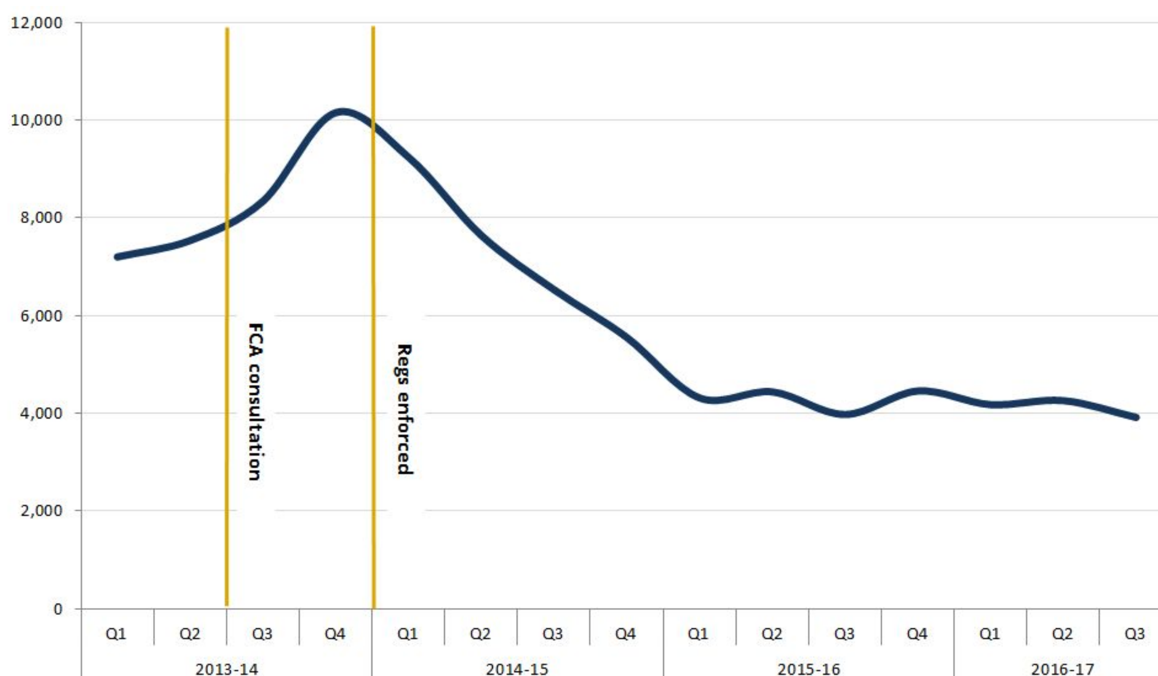
The cost cap on fees and the cap on the amount of times a loan can be refinanced has likely led to longer duration loans as firms now have more incentives to engage in better forbearance practices.

[19] Citizens Advice, (2016) Payday loans: An improved market?.

# Part 4 - Consumers and HCSTC use

## Q10: Do you have views and evidence on the risks for consumers of using HCSTC post-cap? Do you agree with our initial assessment that risks of falling into arrears have reduced?

The total cost cap on high cost credit has been a success. Prior to the consultation on the first set of regulations, Citizens Advice helped people with more than 10,000 high-cost debt issues a quarter. That has fallen by more than half, and is now stable at around 4,000 each quarter.




Source: Citizens Advice

That reduction in problems related to HCST credit has been seen across the Citizens Advice service. There has been:

- A 45% reduction in clients accessing advice about payday loan issues, which is in contrast to the trend with all debt advice which has remained stable and all advice given which has increased slightly.
- An 86% reduction in clients contacting our consumer service regarding payday loans between 2013 and 2016.
- A 61% post cap reduction in unique users accessing payday loan content on the external website.

As set out in Annex 3 of the call for input, that reduction is the result of a number of changes in the market. First, the market has shrunk. Citizens Advice analysis of the HCST credit market in March 2016 found:[20]

- 42% of the 126 firms, who were operating in the market in 2013, had received full authorisation to carry out payday loan or installment loan activity.
- 20% remained active in the market awaiting the outcome of their authorisation application.
- 38% of firms had exited the market either through withdrawing, not applying for authorisation or going into liquidation.

Second, it is driving better outcomes for consumers.

- The decrease in HCST debt issues seen by Citizens Advice is a product of the change observed by the FCA. Between January 2015 and April 2016 the number of loans which incurred default charges halved, from 16% to 8% and the proportion in arrears for more than seven days fell by a quarter, from 16% to 12%. Consumers are also paying less to borrow. In 2014, the average consumer paid £100 in interest and charges to their payday lender. They now pay £60, despite the average loan amount remaining relatively stable at £250.

Nevertheless, there are still a number of issues in the market.

- **The high cost of loans** - The cost of loans still causes large numbers of borrowers difficulties. While delinquency rates have halved, our research found half of consumers had still experienced difficulties paying back their HCST loan. Citizens Advice advisers identified high interest rates as the largest cause of detriment in the current payday loan market, with 37% of the panel identifying this as the main issue.

- **Affordability checks** - The impact of the high-cost of the loans on people's finances is compounded by a failure to conduct thorough affordability checks. In our research nearly three quarters of HCST credit consumers remembered clearly being asked questions about their situation and ability to pay back the loan. In follow up depth interviews, borrowers who had been successful in applying indicated that the affordability checks were still based on information inputted by them, with lenders rarely asking for evidence and proof of financial circumstances.

  Local Citizens Advice also reported cases where firms were still lending irresponsibly despite having carried out affordability and creditworthiness checks, highlighting weaknesses in their lending criteria. The issues included clients obtaining multiple payday loans despite having other debts, firms not taking into account vulnerabilities like mental health or learning difficulties before lending, and borrowers' income being at a level that meant they would never have been able to manage the repayments effectively.

[20] Citizens Advice, (2016) Payday loans: An improved market?.

*A 37 year old woman from Birmingham with two dependent children was given multiple payday loans. This was despite numerous existing debts including priority bills, and being on a zero hours contract and in receipt of benefits. The client fell into a cycle of borrowing due to her inability to pay, which had a detrimental effect on her mental health.*

The importance of firms carrying out these affordability checks appropriately and thoroughly is shown when we see the strong correlation between borrowers who remember being asked about their ability to repay and those who end up facing difficulty. We found 78% of those who didn't have an affordability check experienced difficulty compared to only 40% who remembered having an affordability check.

- **Treatment when in arrears** - There are also ongoing issues when consumers do get into difficulty. Of those who get into difficulties, 53% spoke to their firm, of which just 44% were able to arrange affordable repayment plans. This type of behaviour can exacerbate the borrower's debt situation and force them into repeat borrowing or to prioritise payment of the payday loan over other more important commitments.

  The FCA guidance in CONC 7.3.5 states that firms should 'consider suspending, reducing, waiving or cancelling any further interest or charges' for borrowers in financial difficulty. Half (49%) of payday loan borrowers said that when they spoke to firms to agree repayment plans after falling behind on payments the company did freeze the interest and charges. This shows that firms in some cases are adopting the guidance. It does, however, mean that the other half are not receiving forbearance even after they provide proof of financial difficulty. CONC also includes guidance encouraging firms to signpost or directly refer borrowers in default or arrears to sources of not for profit debt advice.

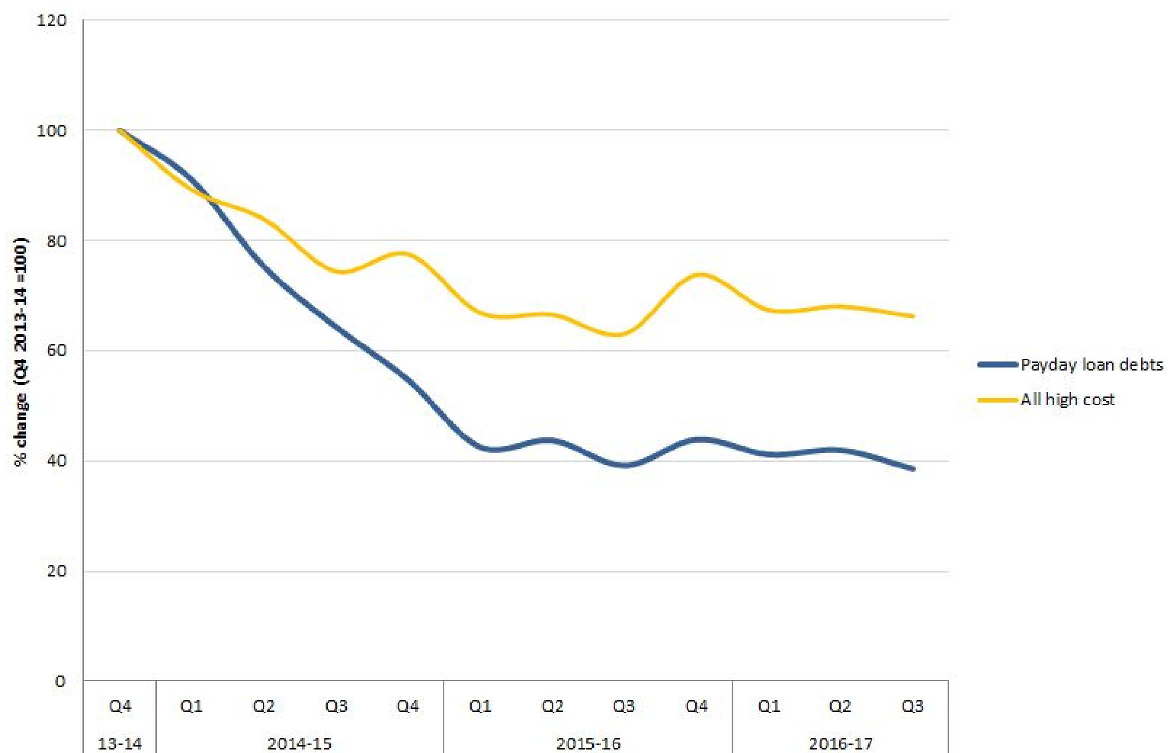
  60% of borrowers who were experiencing financial difficulty were informed about available debt advice following contact with their lender about their difficulties in paying back their loan. As with affordability checks and forbearance, this shows a picture of mixed practice by payday lenders, with many failing to fully comply with FCA guidance.

## Q11: Do you have any evidence of adverse consequences for consumers as a result of being declined for HCSTC?

There are a number of primary concerns about the impact of restricting access to high-cost credit. The first is that it excludes people from accessing credit completely. As shown in our response to question 5, the impact of tightening rules on HCST credit on access to credit more broadly has been limited.

Another concern is that being declined for HCSTC pushes problems elsewhere - the so called 'waterbed effect'. Citizens Advice data does not show evidence of a waterbed effect. Since their peak, the number of issues relating to payday lending have fallen by over half - at the same time, across other high-cost credit areas, issues have fallen by over 30%. The changes to the payday loan market have been overall net-positive for consumers.

**Figure 4: Payday loan problems and all high-cost credit problems. Index Q4 2013/14 = 100**




Source: Citizens Advice

There is also concern around the subsequent behaviour of consumers who are declined. That primarily revolves around an assumption that consumers will simply seek credit from loan sharks. Citizens Advice analysis corroborates the majority of evidence that the cap on high cost credit has not led to an increase in the number of consumers using loan sharks. In depth analysis of Citizens Advice case notes found

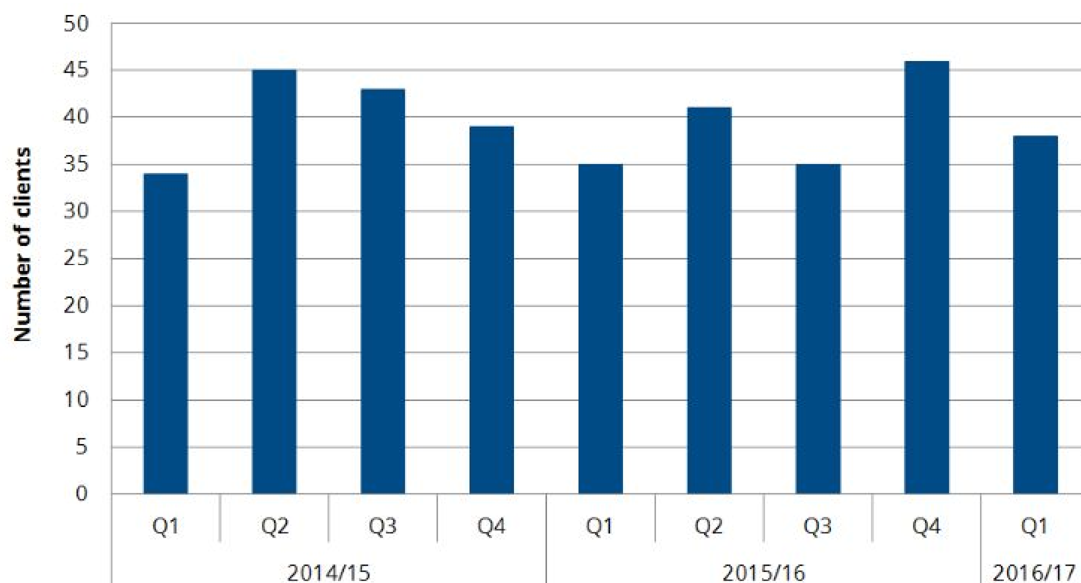
that the number of problems caused by loan shark debts had remained constant since April 2014, as highlighted in Figure 5.

There are a number of reasons that the assumption that consumers will turn to loan sharks does not materialise.

- HCST credit and loan shark debts are not substitutable - they are not used by similar groups of consumers. The Consumer Finance Association for instance found that just 6% of payday loan consumers said they would consider using a loan shark.[21] Around 10% of pre-cap payday loan consumers can no longer access credit. If the proportion is consistent, just 0.6% of payday loan customers would be pushed to even *consider* using a loan shark.
- Most consumers have access to some form of credit. Of those who were declined for HCST credit in our survey, 44% were using a credit card, 35% used overdrafts, and 26 used doorstep lenders.
- Irrespective of access to credit, when consumers are declined they do not look to borrow from elsewhere; 43% decided not to borrow, 25% borrowed from friends or family, 6% used another payday lender and just 4% borrowed in another way.
- For many consumers, that rejection is positive. Fewer than half (37%) of consumers we surveyed felt financially worse off as a result of being turned down for a payday loan. Only a minority (27%) of consumers felt that being turned down for a payday loan had a negative impact on their life. Even those who felt it had a negative impact on their lives often recognised the benefits of not taking on more unaffordable credit:

  *"By being refused the loan it caused financial difficulty. However it made me face up to my issues. CAB helped me to budget and cut back on items which freed up monies and they contacted creditors to help the situation."*

**Figure 5: Clients with loan shark debts**

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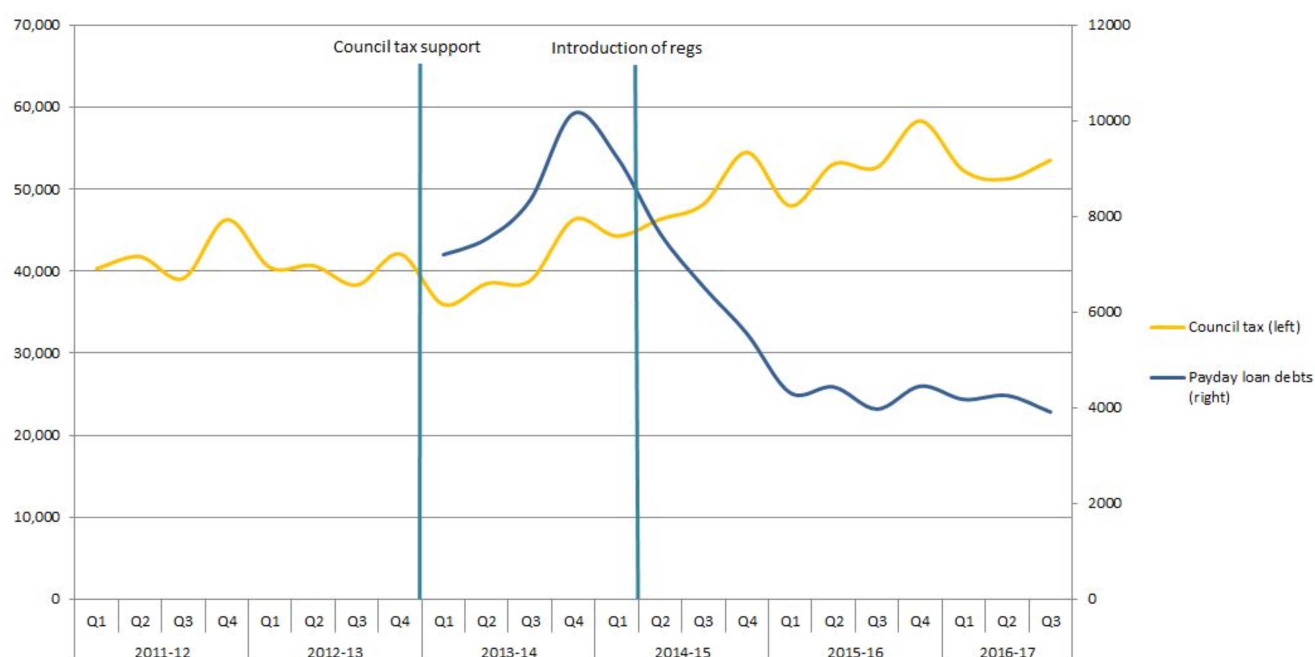
[21] CFA, A modern credit revolution: An analysis of the short-term credit market.

Source: Citizens Advice

The last concern is that being declined HCSTC will lead to household arrears, due to restricting people's ability to smooth their income and so meet regular and fluctuating payments when they fall. Generally, there has been a slight increase in households in arrears over the last five years. Primarily that has been driven by an increase in council tax arrears as a result of the implementation of council tax support. The chart below shows the impact of that on the number of people needing help with council tax debts from Citizens Advices.

**Figure 6: Payday loan problems and council tax arrears problems**




Source: Citizens Advice

More specifically, FCA research shows that consumers who are declined for a payday loan were more likely to be behind on household bills a year after being declined than those. However, that reflects the financial position of people who are declined for loans, rather than the impact of being declined on people's finances.

In fact, the FCA find that being accepted for HCST leads to worsening outcomes, while being rejected doesn't - when you control for initial situation. As set out in Annex 3 of the Call for input:

'We do not observe clear evidence that these consumers were increasingly suffering much worse adverse credit events after HCSTC denial than they would have been expected to, given how their financial situation was already deteriorating.'[22]

[22] FCA, *Call for input* 45-54.

## Q12: Do you agree that consumers do not generally move to other high-cost credit products as a result of being declined for HCSTC?

Most consumers who are declined HCSTC use other sources of credit - nearly half use credit cards and a third use overdrafts. The FCA found that when people were declined, 43% decided not to borrow at all, 25% borrowed from friends and family, 6% borrowed from another payday lender and just 4% borrowed in another way.

We asked our advisers what their clients were doing after being turned down for payday loans. Nearly half (40%) of advisers were unsure. The most common response from the other advisers was that clients are relying on their friends and family for borrowing (28%). Only a small number (6%) indicated that borrowers were turning to illegal lending or unauthorised credit.

Our research also found that of those who are declined for a loan, just over a third said they felt they were worse off financially as a result and only a quarter said it had a negative impact on their lives.

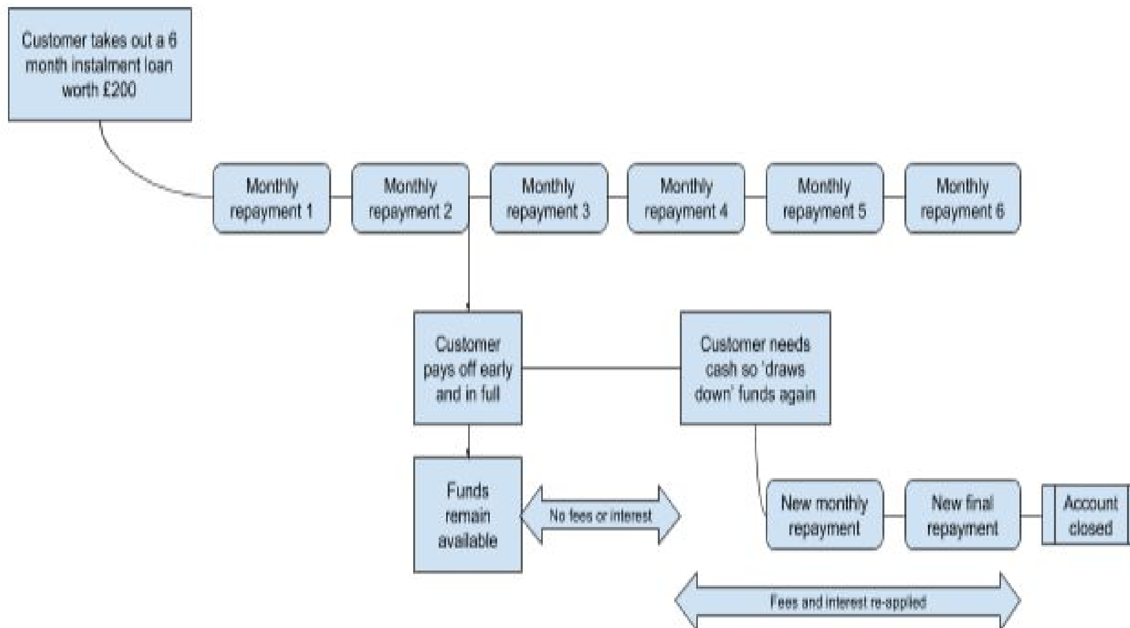
## Q13: What are the implications for consumers of increasing loan duration for HCSTC?

One impact of the cap is that we have seen some evidence of borrowers being offered increasing amounts of credit by payday lending firms. Depth interviews revealed cases where the borrower had not requested the extra credit and did not need it, but given the money was there they felt compelled to use the extra amount. This can lead to customers borrowing more money than they can afford.

It is not clear that lenders are carrying out affordability assessments at this point and instead may be supplying the additional amount based on the borrower's lending history with the firm. Both the case below and Figure 7 demonstrate how this operates:

> *A 50 year old woman had taken out a payday loan for £180 in mid 2015 to cover costs and bills due to her partner being off work for an operation. Then she took another loan of the same amount from a different company the next month. Since then, both firms have increased the credit limit each month and now the borrower has two loans with two companies, with available funds of £400 on each.*

## Figure 7: How companies provide credit over longer durations




This appears to be a consequence of the change of business models some payday lenders have made since the change in regulations. Many firms have changed from the typical short term month loan option to a three to six month installment loan model. The diagram above highlights how some of these appear to be working. The hidden consequence of this development is that firms are keeping borrowers' funds available despite them paying off early and in full. This means that borrowers have an opportunity to take this credit out again, allowing the firm to charge interest again until the borrower pays off in full.

A possible solution would be to restrict unsolicited credit and to require firms to conduct affordability checks each time they lend to a consumer. Early repayment should result in a line of credit being closed.

# Part 5 - Scope of the price cap

## Q14: Do you have views or evidence that the HCSTC price cap has had an impact on other high-cost products: e.g. because consumers use those products as an alternative?

As highlighted in response to Question 11, concerns about a 'waterbed effect' are exaggerated. There are ongoing issues in a range of high-cost credit markets, but they aren't the result of the payday market working against consumers.

## Q15: Do you have evidence that the definition of HCSTC is providing opportunities for firms to evade the HCSTC price cap (and HCSTC regime more generally)?

The primary opportunity for firms to evade the price cap - or avoid it - are the regulatory carve outs provided by the definition of HCST credit.

In particular part (e)(ii) which provides exceptions for three forms of credit:

'(ii) a home credit loan agreement, a bill of sale loan agreement or a borrower-lender agreement enabling a borrower to overdraw on a current account or arising where the holder of a current account overdraws on the account without a pre-arranged overdraft or exceeds a pre-arranged overdraft limit.'

For those firms that do fall under the HCST credit cap, longer duration installment loans allow firms to charge higher levels of total interest without exceeding the initial cost cap of 0.8% a day. One of the implications of that change is described in response to Question 13. The overall impact on the market however has not been distorting. There are a wide range of short and medium term credit products available to consumers within the scope of the cap.

# Part 6 - Repeat and multiple borrowing

## Q16: What are your views on our analysis of the data and market with regard to repeat and multiple borrowing?
## Q17: Do you have any further evidence on repeat and multiple borrowing?

The analysis shows that both multiple and repeat borrowing have become less common. That decrease is positive. However, the analysis of multiple borrowing highlights two issues in the high cost credit market. First, the FCA's analysis shows that multiple borrowing is associated with arrears. That suggests that firms are not taking into account people's level of debt when conducting affordability checks.

Second, it draws attention to the incidence of multiple borrowing in other high cost credit markets. One third of doorstep loan customers we help have more than one doorstep loan, 84% of rent to own consumers pay for more than one item and 28% pay for more than five. High levels of multiple borrowing are indicative of a lack of appropriate affordability assessments.

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