

# High-cost credit: Overdrafts

Citizens Advice response to CP18/42  
High-Cost Credit Review: Overdrafts  
consultation paper



## Executive summary

The rules proposed by the FCA in this consultation are a good first step at reducing the harm of overdrafts as a form of high cost credit, especially in aligning arranged and unarranged overdraft fees. We need, however, greater clarity about what these changes will mean in practice for vulnerable consumers.

Citizens Advice helped almost 30,000 people with overdrafts last year. This makes it one of the most common consumer credit issues we help people with. Of these issues, we helped 24,000 people faced with repaying their overdraft. Nearly 3,000 people had problems specifically related to overdraft charges.

**Overdrafts issues overwhelmingly affect socially disadvantaged people.** Of the clients who came to us with a problem with their overdraft last year:

- 2 in 5 had a disability or long term health condition
- 2 in 5 had a monthly income of less than £1000
- 1 in 5 were from a black, Asian, and minority ethnic (BAME) background
- 1 in 4 were single parents.

**Overdraft fees and charges are a particularly acute problem for people with mental health difficulties.** People with a mental health problem are 16% more likely to have used an overdraft in the last 12 months than the general population.<sup>1</sup> Additionally, people with unpredictable incomes are twice as likely to have paid overdraft charges as those with stable incomes.<sup>2</sup>

**Vulnerable consumers are more likely to be paying costs because of overdrafts, and will be the most impacted by the changes proposed in this consultation.** The impact that overdraft use can have on people's lives can be enormous, and can push people further into debt and compound ill-health. Our response to the consultation considers how the proposed fundamental changes to the overdraft market will impact these consumers. This is split into the areas of harm being consulted on, with relevant questions grouped accordingly. Broadly, these changes will have a positive effect on consumers, especially for increasing consumer understanding and reducing the harm from unarranged overdraft fees.

**However, we have several concerns arising from how firms will implement these remedies in practice.** While requiring firms to use a single representative APR is a positive step in increasing the transparency of overdraft fees, we are concerned about the consequences for vulnerable consumers. There is a lack of transparency about the level of risk consumers will face as a consequence, as well as how higher APR rates will be calculated. This will likely have a particular impact on repeat overdraft users, who are often vulnerable. An evaluation period must include a comparison of the charges associated with arranged and unarranged overdrafts. The FCA must then consider the possible need for a backstop price cap to protect these consumers if, as a result of these remedies, people continue to pay more than the costs associated with a total cost cap.

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<sup>1</sup> Citizens Advice, [The Mental Health Premium](#), 2019; Financial Conduct Authority, [Financial Lives Survey](#), 2018. 25% of all UK adults overdrawn compared to 41% with a mental health problem.

<sup>2</sup> Citizens Advice, [Walking on Thin Ice](#), 2018

***A. Overdraft alignment: We agree that the alignment of prices for arranged and unarranged overdrafts will bring significant benefits to consumers.***

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

**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**

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

**We agree that charges for arranged and unarranged overdrafts should be aligned.**

We also agree that firms should not be able to charge more for unarranged overdraft use, and that charges for unarranged overdraft use should be unenforceable if their level exceeds the level of arranged charges.

**At present, the system of charging differential prices for overdraft and unarranged overdrafts is unfair.** 14 million consumers are using an unarranged overdraft. On average, people who have used an unarranged overdraft use it 4 times a month, typically for amounts of less than £50. Some of these consumers pay over 20% in interest a day. The difference in pricing between arranged and unarranged overdrafts is sizeable. Unarranged overdrafts represented 26% of total overdraft income between 2014 and 2017, but only 4% of total overdraft lending assets.<sup>3</sup>



Kyla is 20 years old and from South East England. When she was 16 she became overdrawn by £5. She asked her bank for help when the debt multiplied to £100, and was told she'd entered an unarranged overdraft. Kyla didn't understand what this meant and wasn't able to pay back this amount. The debt has now increased to over £450 and has been referred to a debt collection agency. Kyla still can't afford to repay this amount. She feels duped as she never understood the terms of her bank account, and doesn't feel that it's right that she should have to pay back almost 100 times the amount she originally owed.

These charges are also highly concentrated amongst a minority of overdraft users. While 14% of consumers have incurred unarranged overdraft charges, 50% of total overdraft fee revenue came from 1.5% of customers - amounting to around £700 million. Consumers in more deprived areas are 70% more likely to use an unarranged overdraft and pay these higher charges than other consumers.<sup>4</sup> These consumers tend

<sup>3</sup> Financial Conduct Authority, [High-Cost Credit Review: Overdrafts consultation paper and policy statement](#), 2018.

<sup>4</sup> Financial Conduct Authority, [High-Cost Credit Review: Overdrafts consultation paper and policy statement](#), 2018.

to have lower incomes, are often from BAME communities, and are more likely to have health problems or a disability.

Vulnerable consumers are being unfairly penalised by the current disparity in charges between arranged and unarranged overdrafts. The average daily fee from being in an unarranged overdraft is £3.23 compared to £0.40 for arranged overdrafts.<sup>5</sup> Aligning charges between arranged and unarranged overdrafts and bringing an end to daily fees will reduce this detriment and stop vulnerable consumers from being unfairly penalised.

**These fees disproportionately affect people with mental health difficulties.** 41% of people with a mental health problem which impacts their life have used an unarranged overdraft at least once within the last 12 months.<sup>6</sup> This number increases to nearly half (48%) of people who are significantly affected by a mental health problem. This is because mental health difficulties can make it harder for people to manage their financial affairs.

Mental health problems can make people more susceptible to entering an unarranged overdraft for a number of reasons. For example, memory problems caused by a mental health problem can mean that people forget when their bills will be deducted from their account, and impulsive behaviour such as overspending can cause people to accidentally enter their overdraft. Problems with working memory can make it difficult for people with mental health problems to fully absorb and consider the long term implications of entering unarranged overdrafts. And certain mental health problems, particularly anxiety, have been shown to decrease people's ability to budget and plan ahead. Problems with financial management also often lead to a lack of access to affordable credit, meaning that people with mental health problems are often forced into using an overdraft.<sup>7</sup>

Other circumstantial factors can increase the likelihood that vulnerable consumers pay overdraft fees. Delays in receiving benefits for example can force people into using their overdrafts despite careful financial management.



Tallulah has depression, a learning difficulty and multiple long term health conditions. While waiting to receive an advance Universal Credit payment, she entered an unarranged overdraft as bills were still being taken from her bank account. The fees she was charged for entering an unarranged overdraft meant that when her payment did come in, it was immediately swallowed.

### ***B. Consumer understanding: We agree that requiring firms to using a single interest rate to measure overdraft charges will increase understanding, we're***

<sup>5</sup> Citizens Advice, [The Mental Health Premium - Research Methods](#), 2019.

<sup>6</sup> Citizens Advice, [The Mental Health Premium](#), 2019

<sup>7</sup> Money and Mental Health Policy Institute, [Overstretched, Overdrawn, Underserved](#), 2017

*concerned however about the impact this may have on less credit-worthy consumers.*

**Q4. Do you agree that firms should be required to charge for overdraft by a single interest rate?**

**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?**

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

**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?**

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

**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?**

**We agree that firms should be required to charge for overdrafts using a single interest rate, and this should be disclosed in advertising.** Many of our clients have faced difficulties by the way overdraft charges are calculated, as seen in the following case studies:



Afua received a letter from her bank letting her know that they would be changing the way they calculate overdraft charges. Instead of being charged interest, she would now be charged 0.01p per day per £7 overdrawn. She has an overdraft of almost £2000 which she needs to use to survive on her low income. She couldn't reduce her overdraft within the timescale before the changes took place, which cost her an extra £50 per month. Afua has mental health problems and struggled to cope before the changes. Her mental health has got worse since the changes took place and she's fallen further into debt.



Caitlin took out an overdraft of £2000 on her student bank account when she was at University. After she graduated, her account changed to a standard current account. Caitlin started being charged £1 per day on her overdraft. While this was happening, her mental health deteriorated and she became homeless. She informed her bank and was told the charges would be stopped, but they weren't. Her debt is now escalating by £30 a month and she has no way of reducing it.

**There is currently a very low level of understanding and engagement with overdrafts by consumers.** Just 8% of customers have switched bank accounts in the last 3 years. 21% of people have looked around but not switched, and 65% have done nothing at all.<sup>8</sup> And vulnerable consumers find comparing providers especially difficult. People with mental health problems especially can find comparing deals and switching provider hard because of problems with working memory, so are more likely to be paying a loyalty penalty than the average consumer.<sup>9</sup>

The proposed changes would therefore, make it easier for these consumers to compare and understand their overdraft. However, we consider the impact that this will have on market competition to be marginal. There are a number of behavioural reasons for this.

**Overconfidence bias is likely to limit the effects of competition in the selection of overdraft accounts.** Overconfidence biases mean that consumers are unlikely to consider overdrafts when picking bank accounts, as they often do not think they will use one.<sup>10</sup> Additionally, the CMA market study set out a wide range of reasons behind people disengaging from current account use - a lack of trigger points, perceptions of limited gains, and low up front costs for the majority of consumers. Clear examples from firms of what charges would look like in practice may help consumers make informed decisions about choosing banks, and understand how much using their overdraft will actually cost. The 2015 UK Financial Capability Survey found that a third of people struggle to calculate interest rates correctly, and find calculating compound debt especially difficult.<sup>11</sup> But while requiring firms to display a single APR for overdrafts would go some way towards reducing the complexity of comparing overdrafts, this will not tackle existing biases.

**Framing effects are likely to inform how people use their overdrafts.** Evidence from Citizens Advice and the Behavioural Insights Team shows that the way that information is framed is an important component of this. Practical examples of cost are more effective at encouraging repayment than warnings alone, and the more effort it takes to compare, the less likely people are to do it and make informed decisions.<sup>12</sup> People are more receptive to examples using pounds and pence figures because calculating interest is especially difficult. A universal comparison tool would make this easier, and therefore help consumers make informed choices. We are satisfied that the example in this consultation of how an overdraft calculator could look would do this. However, this relies on customers being prepared to switch accounts in the first place. Comparison tools alone will not encourage customers to look for better accounts, but would make the process easier for those that do.

**We're concerned that vulnerable people will routinely be offered a significantly higher APR on their overdraft than the representative amount.** The introduction of

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<sup>8</sup> Citizens Advice, [High-cost credit: Overdrafts. Citizens Advice response to CP18/13](#), 2018

<sup>9</sup> Citizens Advice, [The Mental Health Premium](#), 2019

<sup>10</sup> The Behavioural Insights Team, [Applying Behavioural Insights to Regulated Markets](#), 2016

<sup>11</sup> The Money Advice Service, [Financial Capability in the UK 2015](#), 2015

<sup>12</sup> Salisbury, L. C. (2014). Minimum Payment Warnings and Information Disclosure Effects on Consumer Debt Repayment Decisions. *Journal of Public Policy & Marketing*, 33(1), 49–64.

a representative APR and, consequently, risk-based pricing means that people on a low income or those with a poor credit history are likely to be paying more than the advertised price. This will have effects on people's financial wellbeing, but also might not be recognised by individuals who go overdrawn - or those who select an account with an overdraft with a low APR. Research by the Money and Mental Health Policy Institute has found that people with mental health problems are more likely to be in financial difficulty affecting their credit rating, and are likely to find it hard to rebuild a poor credit score.<sup>13</sup> As representative APRs are poorly understood, it is important that the FCA monitors the price paid for overdrafts by consumers across the financial spectrum.

**The FCA should continue to consider the potential for a price cap in this market.**

The FCA must commit to collecting the differential rates offered by banks and present this in a way that means consumers have a clear understanding of what APR they can reasonably expect to be offered. A cap of 0.8% daily interest and repayments no higher than 100% of the overdraft needs to be introduced if, during the evaluation period 12 months after these remedies are introduced, it's found that people are still being charged this amount. This backstop would prevent vulnerable consumers from repaying excessive amounts if they are routinely being offered higher APRs than the representative amount.

In particular the FCA should review the actual prices paid for unarranged overdrafts and arranged overdrafts. Where providers have different rates for different card products, high charges may still be used to effectively charge higher costs for the use of unarranged overdraft use.

***C. Refused payment fees: We agree with recovering costs via refused payment fees, but these must be monitored to ensure fees are fair and reasonable***

**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.**

**We agree that refused payment fees must be as low as possible and reasonable, and must not be used for profit.** Research by Citizens Advice has found that the average fee charged by banks for a refused payment is £6.83, and that multiple firms do not have a cap on the number of times a fee can be charged within a statement period.<sup>14</sup> Nearly half (45%) of people with mental health problems have had payments bounce because of a lack of funds, and typically incur a fee 6 times a year.<sup>15</sup> This has a cumulative cost and can be enough to push vulnerable people into further financial difficulty.

**The FCA must ensure that payment refusal fees are reasonable and actually cover direct costs.** Citizens Advice research identified significant discrepancies between the refused payment fees charged by different banks. This ranges from no fee, to £10 per

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<sup>13</sup> Money and Mental Health Policy Institute, [Credit Scores - a Lasting Reminder of Poor Mental Health](#), 2017

<sup>14</sup> Citizens Advice, [The Mental Health Premium - Research Methods](#), 2019.

<sup>15</sup> Citizens Advice, [The Mental Health Premium](#), 2019



transaction with no cap.<sup>16</sup> The fact that these fees differ so much between firms indicates that it's unlikely they are currently being used to recover costs. Any future regulation must therefore be adequately monitored and enforced to avoid punitive fees. We expect a subsequent narrowing of the range of these rates to avoid penalising vulnerable consumers, especially considering that they are more likely to be using an overdraft than the general population. If these costs do not narrow in the 12 month period after their implementation, the FCA must investigate the most effective mechanism for controlling them.

#### ***D. Timetable for rules: We agree with giving firms 6 months to comply with the proposed rules***

**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 agree with the proposed application of these rules and that 6 months is a reasonable period to comply with them.** The proposed rules should be implemented as soon as is practically possible to limit the harm being caused under current rules. Vulnerable consumers are already more likely to be using an overdraft than the general population, and this comes with a cost; overdraft charges contribute to cumulative extra costs of up to £1,550 a year for people with mental health problems.<sup>17</sup> Overdraft charges can push people into further financial difficulties with additional knock on costs, and can make people's mental health worse.<sup>18</sup> The proposed new rules must be introduced as soon as possible to avoid compounding these costs.



Maro experiences psychosis and works part time. His condition means that his income fluctuates because he has to take time off work. Maro recently received a letter from his bank threatening to close his account because he was £17 overdrawn. The worry over his financial situation made Maro's psychosis worse. He stopped eating to save money and knows that the next time he is unable to work he will be in financial difficulty again. He is worried what will happen next time he enters his overdraft.

#### ***E. Repeat use: We agree these changes are needed to help repeat overdraft users, but these need to be evaluated and, if needed, updated to ensure they work***

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

<sup>16</sup> Citizens Advice, [The Mental Health Premium - Research Methods](#), 2019.

<sup>17</sup> Citizens Advice, [The Mental Health Premium](#), 2019

<sup>18</sup> *ibid*



**We are in broad agreement with the FCA’s proposals to address the harm from repeat overdraft use, but we must see more clarity of what this would look like in practice.** Firms must have consistent guidance to identify and intervene in cases of repeat use. Vulnerable consumers are especially likely to be repeatedly using overdrafts. 1 in 3 people with a mental health problem who entered a planned overdraft at least once in the past year have done so monthly or more.<sup>19</sup> This indicates they are being used by some as a form of financial management, as seen in this case study:



Riz has severe mental health problems. They are on benefits and this is their only source of income. They rely on their overdraft to pay off their credit cards every month, which has meant that it has increased to its limit of £3000. Riz is being charged £82 a month for their overdraft and is falling further into debt as a result.

We’re concerned that this consultation doesn’t go far enough in offering concrete support options for vulnerable repeat overdraft users who rely on their overdraft for day-to-day expenses. A set of mandatory minimum standards is needed to ensure that consumers with mental health problems receive appropriate tailored support and interventions if they are repeatedly using their overdraft.<sup>20</sup> This would offer a consistent strategy to address repeat use amongst vulnerable customers without unfairly penalising them. The FCA must investigate in full what these support options would look like to ensure vulnerable repeat overdraft users are supported and avoid situations outlined in the case studies below.



Tracy is diabetic and experiences mental health problems. She exceeded her overdraft limit and was being charged £24.50 every month. She needs to eat regularly because of her diabetes, but could not access any money and ran out of food in her house. Tracy was suspended from work for taking 80p worth of food without paying for it. She subsequently attempted suicide. Tracy was forced to open a new bank account with a different firm, and needed Citizens Advice’s help to write a letter to her previous bank asking for a freeze on the charges on her overdrawn account. Her old bank agreed to temporarily close her account and stop any charges for a year.

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<sup>19</sup> Citizens Advice, [The Mental Health Premium](#), 2019

<sup>20</sup> In its green paper on ‘Modernising consumer markets’, the government stated that it wants to see action in supporting consumers with mental health problems. Regulators are to consider the case for introducing a set of ‘minimum standards’ these customers should expect to receive across sectors. In our response to the green paper, we welcomed the government’s focus on minimum standards and emphasised that this is an area in which quick, concrete action is needed.



Monét is widowed and her limited income from work is topped up by her late husband's pension. She also has a long-term health problem. Monét has an overdraft of £1000 for the same account that her income is paid into. Her income reduces her overdraft, but not by enough to clear it completely. Monét is being forced to continually live off her overdraft as her income is swallowed as soon as it enters her account. She feels that she is going in circles and trapped by her bank.

**If after review consumers are continuing to pay a daily interest rate higher than 0.8%, and more than 100% of the total cost of an overdraft, a price cap on these terms must be introduced.** A cap would help consumers who rely on their overdraft from facing excessive prices, and reduce the cyclical nature of overdraft debt. As mentioned earlier in this response, this would also offer protection for vulnerable consumers who may be affected by APR price differentials under these new proposals.

**We consider 12 months after these remedies are implemented to be a reasonable timeframe to begin an evaluation.** Any review should not begin significantly later than this period to make sure that any continued harm falling on vulnerable consumers is addressed as soon as possible and suitable interventions introduced. This review must consider four things:

1. If there are significant differentials across the APRs offered by firms, and how much consumers are continuing to pay in daily interest and total charges as a result of these changes
2. If there is a difference in the actual costs faced by consumers for arranged and unarranged overdraft use as a result of having high prices on card products with high unarranged overdraft use.
3. If, as a consequence of those high charges, there is a need for a cap on the daily interest rate of 0.8% and a total cost cap of 100% to ensure people are not paying back more than twice what they borrowed
4. Whether the range of refused payment fees has narrowed, and if subsequent controls on these costs are needed.

***F. Final comments***

**Q15. Do you agree with the changes proposed in this chapter? (Chapter 8)**

Yes

**Q16. Do you agree with our cost-benefit analysis?**

Yes

**For further information**

**If you have any questions please contact [marini.thorne@citizensadvice.org.uk](mailto:marini.thorne@citizensadvice.org.uk)**

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