Which? works for you

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Response to: Financial Conduct Authority's 'High-Cost Credit Review: Overdrafts consultation paper and policy statement'

Consultation Response

Financial Conduct Authority's 'High-Cost Credit Review: Overdrafts consultation paper and policy statement'

Which? welcomes the FCA's consultation and policy statement on its proposals for overdrafts as part of its high-cost credit review. The FCA has rightly set out a package of reforms including price constraints and price simplification. These have the potential to dramatically reduce consumer detriment.

As we have noted throughout our longstanding campaign on this issue, overdrafts can provide a potential means for consumers to make up what would otherwise be a shortfall of funds, but excessively high unarranged overdraft fees and charges cause significant consumer detriment to a group of consumers who are clearly identifiable as being financially vulnerable.

Which? has four key points on the FCA's proposals:

1. **Which? strongly supports the FCA's proposals to require firms to charge the same for arranged and unarranged overdrafts [Consultation questions 1-3]**

While we support the FCA's demand-side remedies, including provide online eligibility tools, cost calculators and overdraft alerts, we agree that these are likely to be insufficient to address the harm caused by excessive prices because the barriers to competition for unarranged overdrafts are substantial.

Which? has repeatedly called for prices for unarranged and arranged overdrafts to be aligned. This approach would prevent firms from targeting the most disengaged and financially vulnerable customers, who are least likely to switch, with disproportionately high punitive charges. We therefore strongly welcome the FCA's proposal to require firms to align unarranged and arranged overdraft prices.

The CMA had raised two potential unintended consequences from price alignment: that it could reduce access to credit, and that it could lead to higher prices for other parts of retail financial services (the 'waterbed effect'), including potentially the loss of free-if-in-credit banking. The FCA has now concluded that neither are significant risks.

The FCA's previous consultation had proposed that some limited differences between the cost of arranged and unarranged overdrafts could be permitted, with these based on significant and reasonable differences in the cost of providing the credit. Which? had suggested that we would be open to such limited differences if there was clear evidence on costs. The FCA's subsequent analysis shows that one firm said there are no significant incremental costs to providing an unarranged overdraft. Other firms were not able to provide reliable or complete information as they do not appear to know the differences in costs. Firms also acknowledged that decisions to provide an unarranged overdraft had become increasingly more automated, which can reduce the cost of administering them. Based on this lack of evidence to justify differences in pricing between arranged and unarranged overdrafts, we support the FCA's decision to require prices to be the same.

We agree that a price cap is not required in addition to the proposed price alignment and price simplification remedies. A price cap could potentially cut off access to credit to some consumers, if firms are not willing to offer credit above the point of the cap. The FCA should, however, review the impact of any price measures that it introduces within 12 months of their implementation, and then reconsider whether a price cap is required.

2. **Which? strongly supports the FCA's proposals to require firms to only charge for overdrafts by a single interest rate and to disclose a Representative Annual Percentage Rate in advertising [Consultation questions 4-7 and 9]**

The FCA's analysis suggests that price alignment could to lead to an increase in prices for arranged overdrafts. This is a trade-off we have always acknowledged. Consumers who just use arranged overdrafts are less likely to be vulnerable and more likely to switch current account provider. Such customers may also just switch to alternative non-overdraft credit products. With prices aligned, this greater competitive pressure on arranged overdraft prices will benefit unarranged overdraft users.

The FCA's proposed remedies for price simplification help to increase competitive pressure by making it easier to compare prices for overdrafts across providers, and with other forms of credit. These remedies are therefore are complementary to the proposal to align arranged and unarranged overdrafts.

While some firms' current pricing approaches seem simple on the face of it, the variation in the use of flat fees and tiered interest rates and fees can make it very difficult to compare against other providers and other credit products. They can also mean that consumers underestimate the cost, as prices are presented per day for example. The FCA's consumer research has clearly shown that a single interest rate displayed with a Representative Annual Percentage Rate, which is required to be shown for all other consumer credit products, can improve comparisons.

Consumers may value pounds and pence estimates for potential scenarios. We therefore agree with the FCA's proposals 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.

3. **As well as collecting and publishing data on firms' representative annual percentage rates (APRs), the FCA should also collect and publish data on the actual interest rates paid by all of a firm's consumers [Consultation question 8]**

While we understand the need for risk-based pricing, with the FCA's proposals to allow individualised interest rates there remain risks that certain customers will be charged interest rates for their arranged and unarranged overdrafts that do not relate to their credit risk. Collecting data on Representative Annual Percentage Rates will not necessarily identify these issues. If firms charge different interest rates to different customers, the Representative Annual Percentage Rates in advertising only reflects the rate firms reasonably expect a majority of consumers responding to the advert to be offered.

As well as requiring firms to report on their Representative Annual Percentage Rates the FCA should therefore collect and publish data on interest rates charged to all consumers by each firm. The FCA should also conduct reviews to understand whether these interest rates are risk-based, and to understand the characteristics of consumers who are charged the highest rates. For the FCA, and other stakeholders to know whether this remedy has been effective it is essential to know the interest charged to consumers.

Also, given that these remedies are designed to both help improve comparison and switching, and to help ensure banks do not treat vulnerable consumers unfairly, it seems appropriate for the FCA to collect and publish information on the distribution and level of overdraft by bank.

4. **We agree that firms should have clearer guidance for recovering costs via refused payment fees but the FCA should also scrutinise what firms' actual costs are and how these relate to the fees they charge [Consultation question 10]**

One of the risks inherent in the FCA's proposed pricing remedies is that firms push up other charges to recoup some of the lost revenues from unarranged overdrafts. A particular concern is that the FCA's proposed ban on overdraft fees will not cover refused payment fees. The FCA's findings show that firms made an estimated £270m through refused payment fees in 2016.

While these fees are permitted by the Payment Services Regulations, as the FCA notes, such fees 'must reasonably correspond to the payment service provider's actual costs'. The FCA's findings show that across different firms these fees range from £5-25 for each declined transaction. These fees appear highly disproportionate to the likely cost to the firm, which is not offering any extra credit to a consumer but simply refusing to make a payment from their account. The wide range of fees also suggests that they are unlikely to correspond to actual costs. Indeed, firms typically impose no such fees in the event of declined debit card transactions or ATM withdrawals, which suggests that there are minimal or no costs to providers of such declined transactions.

It is concerning that the FCA has concluded that there is a similar picture emerging for refused payment fees as for unarranged overdraft charges in terms of the distribution of fees and the vulnerability of the consumers that these fall on. In particular,

- refused payment fees are 'highly concentrated', with 10% of consumers charged for declined transactions, and the majority of charges paid by 1.2% of consumers; and
- on average, consumers in more deprived regions pay 3.5 times as much each year in refused payment fees as consumers in less deprived regions.

Despite these findings, the FCA's proposals are relatively modest for refused payment fees. While we support the need for clearer guidance on how firms ensure these fees correspond to actual costs, this is unlikely to be sufficient. The FCA should also conduct a thorough review of firms' costs. If the FCA does not find clear evidence of actual costs then, as we proposed to the CMA, there is a strong case to consider banning refused payment fees altogether. Such a ban would be consistent with the Payment Services Regulations.

About Which?

Which? is the largest consumer organisation in the UK with more than 1.3 million members and supporters. We operate as an independent, a-political, social enterprise working for all consumers. We are funded solely by our commercial ventures and receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.

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