

# StepChange Debt Charity response to FCA consultation paper CP18/12 – High cost credit

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## Introduction

StepChange Debt Charity is the largest specialist debt advice charity helping people across the UK, with 620,000 people contacting StepChange in 2017. We welcome the opportunity to respond to the Financial Conduct Authority's consultation on high cost credit.

## Rent-to-own

### Q3: Do you agree with our proposals for a point of sale ban on extended warranties?

We agree with the FCA's proposals. However, as noted in our response to question 4, we are concerned that a deferral period of two days is much too short.

We would find it helpful for the FCA to provide greater clarity on the material benefit of extended rent-to-own warranties. Which? advises that extended warranties are rarely necessary due to statutory consumer rights protections.<sup>1</sup> Further, we note that faulty rent-to-own goods default to the provider and the customer has rights of repair, replacement or a refund under the Consumer Rights Act 2015. The benefits of an extended warranty therefore appear to be marginal and to some degree predicated on the implicit non-delivery of consumer rights, .i.e., offering 'unlimited repairs' without charges for call-outs and parts implies the provider would be resistant to accepting that faults present when an item was purchased should be addressed promptly and fully without additional fees. Further, comparing the benefits of an extended warranty with statutory protections is complicated and difficult to do simply and clearly. Even the fact of being sold a warranty will give people the impression that it is a significant protection when in reality customers are purchasing very specific, marginal added value services rather than fundamental protections.

Currently, there is very little clear information available that provides guidance for consumers, rent-to-own providers and advice providers on consumer rights in a rent-to-own context (with the exception of vehicle hire purchase agreements). While it is not the FCA's role to provide this information, we do consider that without this clarification it is difficult to assess the merits of regulatory intervention.

We would, for example, welcome clarification on the question of whether an expectation that customers would continue to pay for goods that had failed would represent an unsuitable credit agreement. CONC 2.2.2.(G)(1) suggests that targeting customers with regulated credit agreements that are unsuitable for them is bad practice. It seems reasonable to assume that providing credit without an assurance that the goods to which the credit is linked will work (or be durable) for the length of the agreement would make a credit agreement unsuitable. In this case, it seems likely that providers should be guaranteeing the quality of goods over the lifetime of an agreement rather than offering extended warranties.

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<sup>1</sup> 'Extended warranties for which you pay are rarely necessary, as you have rights which last up to five years in Scotland and up to six years in the rest of the UK.' <https://www.which.co.uk/consumer-rights/advice/when-can-i-use-a-manufacturers-warranty-or-guarantee>

#### Q4: Is the two day deferral period the right length of time?

We consider a two day deferral period much too short. The deferral period should be sufficient time to give consumers time to reflect on the value and benefits of a warranty, shop around and explore alternatives, and make an informed decision. We note that the Competition and Markets Authority investigation into payment protection insurance recommended a minimum cooling off period for PPI purchases of seven days.<sup>2</sup> A two day period is insufficient to prevent a sales process in which a 'soft pre-agreement' is made and formalised and end the point of sale advantage that leads people to purchase products they would not do so given adequate time for reflection. We suggest a deferral period of at least seven days would be appropriate (this means seven clear days from the day a sale is completed) and would encourage the FCA to consider a period of up to a month. We do not foresee a significant risk of product failure during this period and where consumers do have problems they will be protected by the manufacturer's warranty. We also note that the FCA has included provisions in the relevant draft CONC handbook text that will allow customers to proactively purchase a warranty following one clear day, which means that consumers who see a clear benefit from and wish to purchase an extended warranty will not be unduly affected by a longer cooling off period.

#### Q5: Do you have any comments on the proposal to provide adequate explanations to enable the consumer to make an informed decision?

We note that rent-to-own providers already use extended warranty comparisons as a form of sales literature. We are doubtful that the rules as drafted will prevent this framing of explanations and comparisons as a means of marketing the positives of an extended warranty rather than being frank about its value. We consider that these comparisons could be misleading if they result in people believing that, without an extended warranty, they will have fewer consumer protections than they in fact do. This is particularly true in a rent-to-own context where ownership of the goods has not transferred to the customer during the period of the credit agreement.

To help address this framing issue, we would suggest that the rules are amended so that, rather than forming only a comparison, firms are required to explain prominently the protections provided to the customer under a manufacturer's warranty and statutory consumer protections if an extended warranty is not purchased. To achieve this, the CONC rules should require inclusion in the information given to the customer a clear explanation of what will happen during an agreement where products have or develop a fault in the absence of a warranty, including outside the manufacturer warranty but within the credit agreement period. This information should, if displayed prominently, act

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<sup>2</sup> The CMA *Market investigation into payment protection insurance* concluded in 2009 states (p. 212): *Taking all of the above factors into consideration, we concluded that a prohibition period of seven days would give consumers adequate time to search the market making use of the information in the personal quote, to have the opportunity to see advertisements from other providers and to search for better-value PPI or credit with PPI (and in such cases make use of the credit cooling-off period to switch to an alternative provider of credit and PPI) before any further contact from the distributor or intermediary who arranged the credit. Given the limited number of claims in the early stages of PPI policies, we do not consider that a prohibition period of this length will materially increase the risk faced by consumers of being without cover before they are contacted again by the distributor or intermediary.*

as an anchor that reassures most customers of the protections in place in the absence of an extended warranty. This will mean that consumers are more likely look at a potential purchase in terms of what additional protection they will be purchasing rather than being driven by a marketing strategy that encourages fear about what protections will be lacking if the customer does not purchase an extended warranty.

We also have some concern that the draft rules have the potential to lead to a technically clear but inaccessible terms and conditions-style sheet similar to the form many SECCI sheets take. Such sheets are good sources of detailed information but are often not accessible and unlikely to be good drivers of decision-making. The FCA has set out evidence that rent-to-own customers tend to be people with low incomes under a high degree of financial pressure with limited access to mainstream credit. This means that they are also likely to be more vulnerable and have limited financial experience. As drafted, there seems to be little to prevent providers using the rules as a platform for marketing while complying with the letter but not the intent of the rules. To prevent this, the FCA should test and develop guidance on compliance including a model format that ensures the target audience receives information in a form that allows them to understand and act on the content.

## Q6: Do you have any comments on our proposed definition of rent-to-own?

The proposed definition appears suitable for the present rent-to-own market. There seems to be a possibility that some rent-to-own providers could move to a monthly payment structure to avoid falling within the proposed definition and the FCA should therefore keep this definition and its impact under review.

## Q7: Do you have any comments on the proposed period for firms to implement the new rules?

We support with the proposed implementation period given the urgent need to improve consumer protection for rent-to-own customers.

## Home - Collected credit

## Q8: Do you have any comments on our draft guidance on interpretation of s.49 CCA?

We agree with the FCA's proposal to clarify meaning of section 49 of the Consumer Credit Act. However, the provision for agents to discuss additional borrowing where this is raised by a customer raises the question of how the guidance can effectively be enforced. There are likely to be situations that allow for leading conversations when an agent makes a routine visit to a customer and a casual conversation can inevitably touch on general financial circumstances in a manner that could be framed as leading naturally to the need for refinancing. (The consultation seems to suggest this by

noting that firms are in a position to exploit intimate knowledge of consumers' needs.) The FCA could provide guidance on what is and is not acceptable but this might simply formalise the parameters of a new route to refinancing that would undermine the intent of the proposals. The FCA has stated that the outcome it is seeking is that more home credit customers only discuss refinancing where they wish to do so. We would welcome clarification of how the FCA anticipates monitoring whether this outcome is being achieved, and how success will be measured.

### Q9: Do you agree with our proposed new rules on explaining the costs of refinancing compared with a concurrent loan?

We agree with the proposed rules but have questions about the likely effectiveness of the intervention. Many home credit customers who refinance a loan are likely to be motivated by a combination of a need for additional credit and affordable weekly repayments. (In other words, one reason they do not take out a concurrent loan is that, on a week to week basis, refinancing can initially be a more affordable option, if more expensive overall.) Knowledge that refinancing can entail a higher total cost opposed to concurrent loans may therefore have a limited impact on decisions made by these customers, who are motivated primarily by accessing additional credit at a cost they can afford now.

There are several way the FCA could strengthen the draft rules. The rules should first make clear that home credit lenders have not only a responsibility to explain the comparative cost of different lending options but to treat customers fairly by offering the cheapest form of credit that is appropriate to their circumstances. The rules and guidance should also be clear that the fact of a customer requesting refinancing should be considered a potential indicator of financial distress and the first response of the home credit provider should be to discuss forbearance options such as payment breaks rather than credit options.

More generally, we understand that the intent of the policy is to significantly reduce the volume of home credit loans that are refinanced. We would, again, welcome an indication of what level of refinancing the FCA would consider reasonable in the home credit market. Should this reduction not take place, the FCA should consider a limit on the refinancing of home credit loans. Such a restriction would be appropriate in the light of the evidence set out by the FCA that customers are channelled toward refinancing because it generates more income for firms and commission for agents (3.28). We note the argument set out in the consultation document that the FCA does not wish to constrain access to credit that may be needed in an emergency. However, it is not clear that home credit use differs substantively from payday lending where a limit on repeat lending has been imposed. Indeed, it could reasonably be argued that people are more likely to use payday loans in a financial emergency. Moreover, we consider that home credit customers are particularly vulnerable to marketing pressures that create patterns of repeat borrowing that are detrimental to customers both due to the high cost of credit in these circumstances, which in the long run often works against a customer's financial interests, and the constraints such lending creates on a customer's freedom to pursue better credit solutions. We believe that a limit on refinancing would a more effective intervention to balance continued access to credit with the need to protect consumers.

**Q10: Do you have any comments on the proposed period for firms to implement the new rules?**

We agree with the proposed implementation period.

## Catalogue credit and Store Cards

**Q11: Do you agree with our proposals for new rules clarifying that firms must explain clearly upfront how interest will be charged if the customer does not repay within the BNPL offer period?**

We agree with the FCA's proposals as a positive step but believe that BNPL retail products should be more closely examined by the FCA because they clearly exploit a consumer vulnerability through behavioural bias. BNPL offers encourage consumers to take on debt without considering its cost because they usually expect to pay off the balance before the offer expires. BNPL products are unfair in the sense that cliff edge pricing exploits consumer inertia and are predicated on an assumption that a high proportion of consumer will act against their own interests. The FCA's proposals will draw out a key facet of BNPL offers and help more people to make an informed decision at the point of purchase. However, while the FCA has provided evidence that many consumers are unaware of their commitment should they not repay within the BNPL offer period, the FCA has not offered evidence that this is the primary reason consumers do not repay. Many consumer are also only mistaken about the extent of the cost of credit, not the fact that they will incur interest charges once the offer period expires. We therefore expect some positive impact from the proposals but consider the principal problem to be the structure of BNPL offers. As the FCA looks at these offers in the round (i.e., across the range of retail products for which they are used), it should consider whether they should be allowed at all. Alternatively, the FCA should consider intervening to stop the back-dating of interest so that charges can only apply from the end of the offer period.

**Q12: Do you agree with our proposals to require firms to prompt customers to repay before the expiry of a BNPL or similar offer period?**

We agree with the proposals and believe they will encourage more catalogue and store credit consumers to use BNPL credit products as they intended.

**Q13: Do you agree the rules should not include a specific time or period to issue the prompt? If not, what should it be?**

We agree that it would not be possible to set a single time period that is appropriate for all credit agreements. However, we are concerned that the proposed wording of the draft rule (6.7.16A) is not clear about how a 'reasonable period' before the date at which the BNPL offer expires should be adjudged. Prompts should be issued at a time that gives the customer a reasonable time to repay the



balance before the expiry of the BNPL period and guided by the outstanding balance on an account – people with larger balances should generally receive earlier prompts. As drafted, it is also not clear that the rule will lead to prompts issued in a sufficiently timely manner to allow consumers to plan and act. We accept that these concerns can be addressed in guidance issued to support the rule but also think the FCA could clarify the rule so that it is clear that a reasonable period means a reasonable period to repay the account balance in full before the expiry of the offer period.

#### Q14: Do you have any comments on the guidance on how firms may comply with this rule?

Given that this will be a new requirement for firms, and that incentives for firms operate to some extent against issuing such prompts in a timely manner, we would encourage the FCA to provide examples to guide timing of the prompt. We agree that it may not be helpful to encourage a one size fits all approach: firms may, for example, treat provide prompts to customers with a similar balance at a different time depending on their payment history. However, the FCA should clearly establish norms and expectations to guide policies and decision-making by firms so that the rule operates to give customers a genuine opportunity to repay the balance in full and use a BNPL offer as they intended. In light of the size of the catalogue and store credit market, the FCA should consider behavioural trials and/or obtaining information from firms on the effectiveness of prompts to inform future rules and guidance.

#### Q15: Do you have any comments on our proposals for a three month implementation period?

We support the proposed implementation period given the relatively straightforward nature of the changes. As noted, as the FCA looks more widely at BNPL offers, learning from these interventions should be used to inform effective future rules and guidance.

#### Q16: Do you have any comments on our proposals to extend the existing rules for credit cards and store cards regarding credit limit increases to catalogue credit?

We support the FCA's proposals with the caveat that they should include provisions that replicate the voluntary industry agreement that gives consumers significantly more control over credit limit increases. StepChange remains of the view that credit should only be bought proactively by informed consumers: for rolling credit products this means that people should always be require to opt-in to increases. The FCA notes that catalogue credit customers are a more vulnerable demographic overall but has not set out how it has considered adapting the credit limit rules for this product: while we believe an opt-in should be in place for all credit products, it is particularly relevant for consumers who are more susceptible to detriment due to poor lending practices. While we understand that there may be practical barriers to an opt-in requirement in FCA rules, to be effective practice should go further than the existing rules on credit and store cards and extend to the same provisions as the

voluntary agreement with credit card providers. It would also be helpful for the FCA to clarify if the same regulatory constraints that affect potential opt-in rules for credit cards also apply to catalogue credit, or whether there may be greater flexibility to develop rules.

We note that the FCA has identified that significant unaffordable lending takes place in the catalogue credit market, which means that regardless of consumer's ability to opt in to credit, a root issue is the decisions made by firms to offer inappropriate credit to customers. Being offered credit shapes consumer perceptions of affordability and risk. It is not clear how the proposed rules will address the fundamental problem of unaffordable lending. Alongside the recent clarification of creditworthiness rules, we believe the FCA should continue to monitor unaffordable lending in catalogue credit and reconsider further steps if practice does not improve.

### Q17: Do you have any comments on our proposals for a three month implementation period?

We support the proposed implementation period and would like to see consumers given greater control over the credit they use as soon as possible.

### Q18: Do you have any comments on our proposals to extend the existing rules for credit cards and store cards to not increase credit limits or interest rates for customers at risk of financial difficulties to catalogue credit?

We support these proposals and have provided comment below.

### Q19: In particular, do you have any comments on our proposal to use the same definition of 'at risk of financial difficulties' for catalogue credit?

We agree that the definition of 'at risk of financial difficulties' used for credit and store cards should be used for catalogue credit. However, we also believe that the definition should be extended in the light of the evidence set out in the consultation document of a high delinquency rate among catalogue credit users (4.32). StepChange previously argued that the definition of financial difficulties should be extended to include signs of persistent debt and remains of the view that it is unhelpful to extend credit to people who are likely to be targeted in future with persistent debt interventions.

### Q20: Do you agree with our proposals that firms should have to take steps to be compliant as soon as the rules come into force?

We would like to see more people experiencing financial difficulty identified and supported as soon as possible and support the proposed timetable.



**Q21: Do you have any comments on our proposals to extend the existing rules for credit cards on earlier intervention to catalogue credit and store cards?**

We agree with this proposal. As noted above, we would like to see payment patterns that are suggestive that a customer's account will come within the definition of persistent debt included in CONC 6.7.3 (and related definitions of financial difficulty).

**Q22: Do you consider that there are any particular aspects of data that is particular to catalogue credit and store cards which firms in these markets should also monitor?**

Once rules requiring clear information and prompts linked to the expiry of a BNPL offer period are in place we can expect that it is unlikely most consumers will not clear the balance of a card before the expiry period. Not clearing a balance within the BNPL period should at this stage therefore be considered an indicator of possible financial difficulties. Payment patterns at the end of the offer period will quickly give a firm an indication of whether a customer is able to pay off the balance within a reasonable period. Firms should therefore be paying particular attention to the period at which an offer expires. **Q23: Do you have any comments on a six month transition period for implementation?**

Given the importance of preventing emerging persistent debt and that the FCA is extending the scope of an existing rule, we believe a shorter implementation period of three months would be appropriate.

**Q24: Do you agree with our proposals to extend the existing rules for credit cards on persistent debt to catalogue credit and store cards?**

We agree with the proposals but would question whether the same timescales applicable to the credit card interventions should be transferred directly to catalogue credit and store cards rather than shortened. The FCA has set out why a repayment period of 3-4 years is likely to be inappropriate for catalogue credit and store cards, which generally have lower balances than credit cards. This also means that it could be appropriate to reconsider the time over which it is reasonable to assess

whether a customer is in persistent catalogue credit or store card debt. We would welcome clarification of whether and how the FCA has considered this issue.

StepChange has broadly supported the persistent credit card debt remedy package but noted in our response that the measures have limitations that mean the consumer detriment and high cost of using credit cards for long-term borrowing will not be adequately addressed. These include:

- The emphasis of the rules is on supporting people in persistent debt rather than preventing entry into persistent debt.
- The timing of interventions does not substantially change the amount repaid or the length of repayment for those struggling with persistent debt compared to the pre-existing situation. Repayment pathways of up to seven years are excessive for products designed to be affordable to consumers. The nature of revolving credit also means that those who come out of the definition of persistent debt between 18 and 36 months could still be repaying their balances over a considerable period of time (such as over ten years).
- There is no requirement for firms to offer customers a timely, affordable way to repay once they enter persistent debt, only at the later stages of the proposed interventions, which puts the emphasis on consumers to act rather than firms to offer a viable repayment pathway. Where forbearance is ultimately applied, existing rules will not go far enough as our clients experience indicates forbearance is currently not always consistently and effectively applied.
- As noted, the early intervention and persistent debt remedies are not sufficiently aligned. The early intervention remedy is focused on preventing financial difficulties from occurring at an earlier stage which is welcome. However, the early intervention remedy does not provide a mechanism for intervening early to prevent persistent debt, which is associated with financial difficulties.

We expect the credit card persistent debt remedy package to have a positive impact but, in the light of these issues, we believe there remain important opportunities to reduce persistent debt through more effective responsible lending standards, a default product structure that encourages timely repayment from a consumer perspective (i.e., through higher minimum repayments), and a set of obligations on firms to respond to signs of repayment difficulty with a clear pathway for affordable repayment.

## Q25: Do you agree with our proposals on the implementation period?

Yes.

## Q26: Do you agree that we should adapt the guidance to remove the reference to a reasonable repayment period of 3 to 4 years?

We agree with this proposal alongside the commitment to set an expectation in guidance that repayment periods will be shorter than 3 to 4 years except in exceptional circumstances.

Q27: Do you have any comments on our definition of 'retail revolving credit'?

We have no comment at this time.

Q28: Do you have any comments on what types of product may be caught over and above catalogue credit and store cards?

We have no comment at this time.

## Alternatives to high-cost credit

Q29: Do you have any comments on our draft guidance for registered social landlords?

We have no comment at this time.

## Equality and Diversity Assessment

Q30: Do you agree with our initial assessments of the impacts of our proposals on the protected groups? Are there any others we should consider?

We have no comment at this time.