StepChange Debt Charity response to FCA consultation paper CP18/13 – Overdrafts

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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 high cost credit review consultation on overdrafts.

Around half of StepChange clients (49.8%) have accumulated overdraft debt, of an average of £1,607, at the point they seek debt advice.[1] This compares to estimates that between a third and a half of PCA holders use an overdraft at least once a year with a typical overdraft credit utilisation of £250.[2] On average, clients with overdraft debt surveyed by StepChange had been in their arranged overdraft 11 out of the last 12 months.[3] Almost two thirds of StepChange clients (62%) with overdraft debt have regularly had to exceed their arranged overdraft limit, doing so in an average of five out of the last 12 months.[4]

Given the apparent prevalence of overdraft debt among people experiencing problem debt, StepChange has sought to engage with its clients to understand their experience of overdraft use through two pieces of work: *Falling into the red* in 2016 and *Stuck in the red* in 2018. Insight gained from our clients, our own data and evidence produced by the FCA indicate there are several systemic problems linked to overdrafts:

- Significant evidence of unaffordable overdraft lending demonstrates that overdrafts are not currently subject to effective creditworthiness and affordability assessments, either when an account is opened or at the point of subsequent adjustments to an overdraft facility. Crucially, persisting ambiguity over the nature of overdrafts as a credit product undermines adequate creditworthiness assessments.
- Many people do not have a high level of awareness of how an overdraft works as a credit product and, due to this lack of knowledge, are not in a position to manage their overdraft use proactively or to the same degree as other credit products.
- Unauthorised overdraft fees are disproportionately high both in comparison to alternative forms of credit and costs and revenue to firms.
- Signs of financial difficulty are often not used by PCA providers to intervene and support customers to avoid persistent overdraft debt.
- Repeat unauthorised overdraft fees are incurred primarily by a small group of customers who are more likely to be financially vulnerable and tend to compound existing financial difficulties. Incentives for account providers are to enable repeat and persistent overdraft debt even when this is obviously not in a customer's interests.
- When people become trapped in persistent overdraft debt, account providers rarely offer help or intervene proactively to provide forbearance and an appropriate debt repayment solution.

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[1] StepChange Debt Charity (2018) *Statistics Yearbook 2017*
[2] GfK NOP (2015) *Personal current account investigation: A report for the Competition and Markets Authority*; Financial Conduct Authority (2018) *High-cost Credit Review: Overdrafts Consultation Paper CP18/13*
[3] StepChange Debt Charity (2016) *Falling into the red: How overdrafts can lead to problem debt*
[4] StepChange Debt Charity (2016)

As the situation currently stands, overdraft facilities are a flexibility that can become toxic for many people who experience financial difficulties. Overdraft use can too easily transition from appropriate use of a short term or emergency credit facility to inappropriate use as a long-term credit facility. We are generally supportive of the proposals the FCA has outlined, which have the potential to help consumers manage their overdraft appropriately and significantly reduce the additional burden of high overdraft fees faced by people who experience periods of financial stress and debt problems.

This noted, we are also disappointed that the central problem of creditworthiness and affordability of overdraft lending has not substantively been addressed by either the high cost credit review or the recent FCA revision of creditworthiness rules. Issues such as ambiguity over a reasonable period in which an overdraft should be repaid and the complexity of patterns of overdraft use mean that overdraft lending poses a special creditworthiness problem. Currently, it simply is not clear how banks are making these creditworthiness assessments and reassessing affordability over time as people's financial circumstances change. In the light of evidence of unaffordable overdraft lending takes place, we would like to see the FCA pursue concrete steps to shed light on this issue and develop clearer standards to guide responsible overdraft lending. At present, we believe an opportunity has been missed to address a key systemic driver of problems linked to overdraft use. We understand that the FCA will continue to develop a programme of work to better understand consumers' experience of financial products, including the interaction of different credit products. We believe there remains an important opportunity to investigate both overdraft lending and the interaction between overdraft debt and wider debt problems.

Q1: Do you agree that the threshold for application of the overdraft eligibility and overdraft alerts rules should be set at bank and building society brands (excluding private banks) with 70,000 or more PCAs?

We have no comment at this time.

Q2: Do you agree that firms should be given 12 months to comply with the proposed rules?

We have no comment at this time.

Q3: Do you agree with our draft rules to require firms to offer an online overdraft eligibility tool which indicates the likelihood of a consumer being eligible for an overdraft facility?

We agree that this proposal has the potential to help customers with an overdraft to reduce the charges they pay and encourage greater competition that might reduce costs and improve services to customers. This noted, we have some concern that this proposal has the potential to work against other interventions proposed in CP18/13 because it could further normalise the perception of overdrafts as a credit product rather than a short-term safety net to be used in emergencies.

We would suggest that the proposed rules are amended to ensure that the eligibility tool does not drive unintended effects by ensuring it is contextualised with suitable information noting the risks associated with overdrafts and highlighting that they are intended as a short-term product, in line with the information required (or encouraged) in the draft BCOBS text (sections 4.43 and 4.47). This approach would retain the benefit of the tool while helping to ensure that it supports the FCA's intended outcomes.

Q4: Should we require firms to design tools in a way that could be provided through APIs to third-party providers so that the same comparison can be run for a consumer across different banks?

We agree with this proposal with the caveat noted in our response to question 3.

Q5: Do you agree with our draft rules to require firms to provide clear, easy-to-read, prominent information about overdrafts to their customers before they apply for an overdraft?

We expect the proposed information to have some impact but would like to see the rules strengthened to ensure they act as a driver of behaviour change. As drafted, the rules will place the emphasis of the information that must be provided to consumers on the type of general information that the FCA's research into consumers' use of overdrafts suggests is often ignored, missed or misunderstood by consumers.[5] Given the FCA's clear evidence that understanding of overdrafts as a form of credit is low and that this lack of understanding contributes to consumer harm, we are surprised that the proposed rules make providing information about the intended role and use of overdrafts that substantively addresses these concerns optional (2.2B.4 and 4.4.7 G). To form an effective intervention, information making clear that overdrafts are intended as a form of short-term borrowing and are unsuitable for long-term or repeat use should form part of the mandatory information provided to PCA customers. This information must be sufficiently strong to challenge entrenched perceptions of overdrafts as a 'safe', low cost flexibility attached to a current account. This might mean, for example, agreeing a standard form of 'cold, hard' wording for a risk warning to be included by all banks.

Q6: Do you agree with our draft rules that online calculators should be made available to show consumers how much they will be charged for their overdraft and allow consumers to calculate their costs?

We agree with the FCA's proposals to require firms to make available an online calculator but are concerned that the draft rules mean that this measure is unlikely to have a significant impact on consumer behaviour. Harmful costs to consumers accumulate through patterns of repeat and

[5] Atticus Market Research Consultancy (2018) *Consumer research on overdrafts*. London: Atticus Market Research Consultancy.

persistent overdraft use rather than through isolated use of an overdraft facility. The proposed rules would allow consumers to calculate one-off examples of overdraft use but not the cost of using an overdraft facility for a certain number of months of the year. To be useful a calculator must allow people to view representative scenarios. This problem could be addressed by requiring that the calculator includes a 'number of months' option and/or that the calculator is accompanied by illustrative examples. We appreciate that there are constraints on the ability of a calculator that is simple to use and understand to represent sometimes complex consumer pathways. However, we would encourage the FCA to consider how a calculator can best support consumers to understand a representative range of scenarios rather than an idealised single use situation. This might, for example, mean extending the requirement to make available a calculator to a package that includes a calculator alongside a set of representative case studies.

Q7: Do you agree that rules requiring consumers to be automatically enrolled into unarranged overdraft and refused payment alerts should be included in the FCA Handbook?

Yes.

Q8: Do you agree with our draft rules to require firms to automatically enrol their customers into arranged overdraft, unarranged and refused payment alerts?

Yes.

Q9: Do you agree with our draft rules regarding alert channel, content, scheduling and grace periods?

Paragraph 8.4.8 (2) refers to alerts sent through a push notification from a mobile banking application. We are unclear if these rules imply that an alert sent through an application can substitute for a SMS text message. We would be concerned that push notifications can be turned off and that it is common for mobile users to do so across all applications. There is no guarantee that someone will use an application and notice an alert in the timeframe when they can usefully act on an alert linked to an overdraft. Relying solely on push notifications through a mobile application would risk the possibility that consumers would not receive the prompts and warnings without consciously opting out. One solution would be to require that firms notify customers who opt for alerts to be sent via notifications that notifications must be enabled on their device in order for them to receive timely warnings.

As drafted, it is not clear that banks will be expected to tailor mobile alerts for customers who repeatedly incur overdraft fees. This might include, for example, noting cumulative charges to date in an annual period as well as pending charges, and signposting advice. We note the FCA is considering a wider remedy package around persistent overdraft debt. A key opportunity will be to use early engagement opportunities like alerts to make people showing patterns of potential emerging persistent use aware of their situation and redirect them to advice from their bank or debt advice providers.

Q10: Do you agree with our draft rules to require that if a firm refers to 'balance', 'available funds', or 'available balance', this must exclude any arranged overdraft available to the customer?

Yes.

Discussion questions

Q11: Do you agree with our approach to harm in this chapter? Do you have any comments, observations or evidence which would be relevant to this part of our analysis?

We broadly support the FCA's analysis of the nature of harm caused by authorised and unauthorised overdraft fees. A recent survey of StepChange clients suggested that the most common reason customers who are under financial pressure and experience indebtedness use an overdraft facility is to pay for everyday expenses such as groceries, clothes and utility payments.[6] In other words, regular use is often driven by necessity. The FCA's evidence separately indicates that a high proportion of unauthorised overdraft fees are concentrated on a minority of customers who tend to live in more deprived areas and are more likely to have vulnerable characteristics.[7] These findings are consistent and suggest that harm arises from the interaction of the characteristics of consumers and a product design that is unresponsive to the needs of these consumers.

Overdrafts that are well-designed to meet customers' needs should be balanced products. This means that an overdraft provides flexibility to meet its intended purpose as an emergency short-term credit facility while being proportionate in scope to a customer's means, but does not exacerbate financial problems either through extending an excessive line of credit that it is difficult for a customer with a fixed income and expenses to repay, or by pulling someone further into debt through excessive or unfair fees.

We agree broadly with the drivers of harm the FCA has identified. However, we believe the FCA has not placed sufficient emphasis on wider drivers of harm:

- **Overdrafts are not subject to adequate creditworthiness and affordability assessments.** A lack of clarity around what constitutes a 'reasonable period' for repaying an arranged overdraft contributes to the problems customers experience because in the absence of a clear creditworthiness framework people are routinely provided an overdraft facility that is

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[6] StepChange Debt Charity (2017) *Stuck in the Red*
[7] Financial Conduct Authority (2018) *Strategic Review of Retail Banking Business: Models Progress report*.

inappropriate to their financial circumstances. The nature of overdrafts as a permanent rolling credit facility means that firms tend to adjust an overdraft on a reactive basis, often in response to problems, rather than proactively in response to a customer's changing circumstances. We note that research commissioned for the Competition and Markets Authority retail banking market investigation suggested that a significant proportion of account holders would not be offered the same overdraft facility if they switched account, highlighting that it is common for an overdraft facility to slip out of sync with a customer's financial circumstances.[8]

- **Overdraft limits are routinely increased without a request by the customer.** StepChange clients often highlight that their overdraft was extended with seemingly no link to an increase in income or any request on the customer's part. In the context of low public understanding of overdraft fees, and the high level of those fees, these unsolicited increases put consumers at greater risk of harm.

- **Firms often do not respond to signs of problematic overdraft use and intervene early to prevent repeat and persistent overdraft use from occurring.** The structure of overdraft fees, with relatively large fees accumulating quickly, makes it imperative that customers have the chance to end overdraft use before the point beyond which the cost of credit escalates. This is a key point of transition and risk for customers: beyond a certain level of use, the cost of credit itself affects a customer's financial circumstances and means that overdraft use can easily become self-perpetuating with high fees making it difficult to pay off the principle.

  Overdrafts are often the first safety net for people who experience an income shock, whether permanent or temporary, and the first recourse of people who begin to struggle with debt repayments. Yet firms rarely engage with customers proactively in these circumstances and it is hardly surprising that, left unsupported, problems tend to escalate before intervention occurs, usually prompted by the debt advice process.

  In a recent survey, the majority of StepChange clients with overdraft debt who had approached their bank for help reported that they had not received a helpful response: they were not offered a solution and interest fees and charges continued to be added to overdraft debt beyond the point at which they could afford to pay.[9] This trend illustrates the unfair nature of overdrafts: the product is designed in a manner that means it is likely a proportion of customers will experience difficulty, and there are few obligations on firms to prevent avoidable problems or help when those difficulties occur.

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[8] Competition and Markets Authority (2016) *Retail banking market investigation: Final report*.
[9] StepChange (2017)

Q12: Do you have any comments, observations or evidence about the range of potential remedies we have discussed?

We are broadly supportive of the package of proposals the FCA has set out to address the harm caused by unauthorised overdraft fees and have provided comment on each element of the proposals:

- **Price simplification and alignment.** We strongly support the FCA's proposals to ban unauthorised overdraft fees by requiring that authorised and unauthorised overdraft fees are aligned. Unauthorised overdraft fees are disproportionately high, compound financial difficulties at the point people most need flexibility and are more likely to fall on the financially vulnerable. Despite the implementation of the maximum monthly cap, monthly fees remain sizeable in the context of the resources of people who have been unable to clear their overdraft. As the FCA has identified, for the small proportion of users who regularly pay unauthorised overdraft fees, these costs are a significant contributor to debt problems.

  The FCA should pursue a package of remedies that ensures overdrafts are used as intended, as an emergency credit facility, and prevents customers from accumulating disproportionately high fees or becoming trapped in a cycle of overdraft lending. A simplified fee model would help protect customers in financial difficulty against unfair costs while realigning incentives for account providers to manage an overdraft facility proactively in a customer's interests.

  We also agree that requiring banks to structure fees using a simple interest rate and expressed as an APR figure is an appropriate framework. This would bring overdraft charges in line with other forms of credit and improve the transparency of charges. This noted, ensuring customers understand the overdraft charges they are likely to pay will require that fees are communicated through a variety of routes, not simply as an APR figure. Unfortunately, there is unlikely to be a single effective way of ensuring charges are transparent, since even with a simple fee model there will be a variety of circumstances under which overdraft fees can be paid. We would encourage the FCA to promote a 'package' approach that synthesises carefully targeted information based on behavioural research, practical tools such as the proposed calculator alongside representative case studies and examples, and engagement with customers who use an overdraft through advice from a bank and, where appropriate, not-for-profit debt advice services.

  With regard to a potential unauthorised overdraft uplift, we consider that this is likely to undermine to some extent the benefits of the simplified fee model the FCA has proposed. We recognise that an uplift is likely in practice to represent a much smaller fee than is charged at present for using an unauthorised overdraft. We are also aware that, if providing an unauthorised overdraft facility carries additional costs in comparison to an authorised overdraft, there is some risk that banks withdraw a useful flexibility from customers in response to a ban on unauthorised overdraft fees. However, we note that where banks have chosen to reform overdraft charges and end unauthorised overdraft fees, they have not felt it necessary to provide for an uplift of this type. We also believe that such as uplift is likely to muddy the expectations of account providers in managing an overdraft.

- **Prohibiting buffer cliff edge pricing.** We also agree that the FCA should include provisions to ban the use of stepped thresholds within an overdraft facility. Such thresholds represent poor practice in lending – creating blunt thresholds at which costs increase – and add complexity to fee models. The overall success of the remedy package rests on consistency and simplicity. There is also a risk that such thresholds would become more common in response to a ban on unauthorised overdraft fees, which would undermine the effectiveness of the remedy package.

- **Backstop price cap**. For customers in repeat or persistent overdraft debt, fees can accumulate in excess of the cost of credit and do so in a manner that distorts incentives for account providers to support customers. This leads to detriment for customers directly through excessive fees and indirectly through a failure to lend responsibly to people experiencing financial difficulty. In addition to a ban on unauthorised overdraft fees, we consider that there is a strong case for both a monthly price cap on remaining overdraft fees and a further backstop cap over a longer period, both set independently by the FCA.

  The monthly maximum charge on unauthorised overdrafts fees has benefitted heavy users but is unlikely to have led to significant change in overdraft charges for most customers. The range of the caps set by banks demonstrates the relative arbitrariness of present unauthorised overdraft fees. We would encourage the FCA to use insight and evidence gained from the Strategic Review of Retail Banking Business Models to propose a monthly fee cap.

  The FCA should also decisively remove the incentive for banks to tacitly foster repeat and persistent overdraft use (because fees and profit accumulate in excess of the costs of forbearance for a minority of users). This means that at some point customers should stop paying charges on a negative balance. To achieve this, alongside a monthly cap a backstop cap should be placed on overdraft charges that operates on a cumulative basis: monthly fees would accumulate against a cap set over an extended period such as a year (i.e., if a customer paid an overdraft fee in a first and third month but not the second month, these fees would be 'linked' and accumulate against the cap). The cap period would revolve beginning from the first instance of overdraft use. We recognise that there are difficult design questions involved in developing a backstop cap and would encourage the FCA to assess the relative impact of different options, including this combined monthly and cumulative approach.

- **Refused payment fees**. We agree that refused payment fees should, at a minimum, be cost-reflective. However, the FCA should also include these fees in any cap (as they are included in the monthly maximum cap on unauthorised overdraft charges). The experience of

StepChange clients is that refused payment fees are a significant cause of financial difficulty alongside unauthorised overdraft charges, particularly where a series of scheduled payments fail. Once people become financially vulnerable, refused payment fees become an additional driver of hardship. We note that basic bank accounts do not allow such fees. We also note that at the point refused payment fees are repeatedly charged to a customer, there is a strong argument that account providers should usually already have intervened to restructure an account (through separating overdraft debt and arranging for affordable repayment).

Q13: Are there other remedies we could consider to address the high level of fees or complexity of price structures? Please explain what the impact might be, why such remedies would be appropriate, and any evidence you have to support your views.

One issue we would like to highlight is that it matters when overdraft fees are charged to an account. For many people, the further in the month it is from the date they are paid or receive other income (such as a Universal Credit payment) the more likely it is that the fees will prompt additional payments (by pushing an account balance below zero or beyond an authorised overdraft threshold). We would consider it good practice to engage with customers and exercise discretion in the timing of payments. We would also suggest a useful flexibility for customers would be to be able to choose when such fees are applied. This is a small change that has the potential to make a significant difference to customers and we would welcome further work from the FCA to engage with banks about the feasibility of including this flexibility in an early intervention package.

Q14: Do you agree that repeat overdraft use is a harm that we should address? Please explain what pattern(s) of repeat use that you would consider problematic, and provide any evidence that you may have to support your views?

We agree that repeat overdraft use is a harm that the FCA should address. An overdraft facility can be an aid to people managing financial difficulties: it allows people to make important payments when they experience an unexpected financial problem such as a delayed paycheck or a financial 'pinch point' such as a month in which an unusual payment must be made, like a housing deposit. However, the pattern we often observe among clients is that overdraft debt exacerbates financial problems through repeat and persistent use.

We consider that the point at which repeat overdraft use becomes harmful is at the transition from occasional emergency use to regular repeat use. On average, clients with overdraft debt surveyed by

StepChange had been in their arranged overdraft 11 out of the last 12 months.[10] This compares to an average of eight months in the last 12 for all arranged overdraft users.[11] What is notable different among StepChange clients is the degree of overdraft credit utilisation: as noted in the introduction to this response, the average overdraft among clients with this form of debt is £1,607. These figures are suggestive that people at risk of problem debt are slightly more likely to use an overdraft facility regularly but significantly more likely to utilise a larger proportion of their overdraft. These patterns mean that identifying problematic use is not just a question of whether an overdraft is used repeatedly, but how it is used repeatedly.

Risk seems to develop through patterns linked to financial pressure as people who sometimes find it difficult to meet general day to day expenses become regular overdraft users. We have also noted that clients with wider debt problems, such as a payday loan or credit card debt, will often use their overdraft to make credit payments when they lack other means to do so. The more often an account balance dips into an overdraft, or further into a negative balance, the more likely it is that fees will compound financial stress and cause a customer to slip from occasional use into persistent overdraft debt. The product structure of overdrafts contributes to this risk: unlike other credit products there is no requirement to repay a proportion of the 'principle', making it more likely that debt that is difficult to repay will accumulate and persist.

A second pattern we can observe among StepChange clients involves a more abrupt transition into significant overdraft debt driven by an unexpected or unavoidable income shock, such as losing a job. In this case, someone will move from being in credit in their account or having a manageable overdraft to utilising all or a significant proportion of their authorised overdraft in a short space of time and without any immediate means of reducing the overdraft debt. Monthly fees then tend to act as a significant drag on someone's ability to reduce outstanding debt.

Whether because they have moved slowly or abruptly into significant overdraft debt, it is common for people in this position to regularly pay unauthorised overdraft fees. Almost two thirds of StepChange clients (62%) with overdraft debt have regularly had to exceed their arranged overdraft limit, doing so in an average of five out of the last 12 months.[12] This is unsurprising given that such customers tend to have approached or exceeded the limits of their overdraft facility. At this point most people would be better off separating overdraft debt and ending use of the overdraft facility. However, it appears far more common for customers to keep up payment of unauthorised overdraft fees until doing so becomes financially unsustainable. Of StepChange clients who report contacting, or being contacted by, their bank before seeking debt advice, only a minority were offered forbearance, with 11% or less reporting some form of helpful response, including forbearance.[13] In practice, the trigger for forbearance tends at present to be the debt advice process.

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[10] StepChange Debt Charity (2016)
[11] Financial Conduct Authority (2018) *High-cost Credit Review: Overdrafts Consultation Paper CP18/13*
[12] StepChange Debt Charity (2016)
[13] StepChange Debt Charity (2017)

Q15: Do you have any comments, observations or evidence about the range of potential remedies we have discussed, or when we should intervene?

Occasional use of an overdraft facility is a flexibility that works favourably for most customers; repeat and persistent use does not. Overdraft products are currently structured such that there is little likelihood of interventions occurring to prevent people at risk from developing harmful patterns of use, and few incentives for firms to intervene to end harmful patterns of use when they develop. We welcome the specific proposals the FCA has set out on overdraft fees but also agree that the harm caused by repeat overdraft use warrants further intervention.

We believe the FCA should seek to develop a package of remedies that retains the benefit of overdrafts as an emergency credit facility while redirecting people at risk of developing persistent overdraft debt to more appropriate solutions, such as re-budgeting or an alternative credit option. Crucially, this must include <u>preventing</u> persistent debt from occurring as well as intervening to support those in persistent overdraft debt.

We have provided comment on each of the potential areas of intervention the FCA has set out:

- **Adequate systems in place to assess whether customers are in, or at risk of, financial difficulties and take appropriate action.**

  Firms appear to use largely automated processes to manage overdraft facilities. These processes work least well for customers at risk of financial difficulty because relatively high levels of risk for banks is priced bluntly into overdraft fees. This product model reduces the incentive for firms to develop more responsive systems to better match an overdraft facility with a customer's needs. Developing systems that can identify customers at risk of financial difficulty therefore has implications for the way that banks design and offer overdrafts.

  The ideal time to identify whether customers are at risk of financial difficulty is before an overdraft is offered. In practice, we recognise that most customers will already have a rolling overdraft facility. We suggest that firms should be required to develop systems for assessing the affordability of overdrafts that include both a regular (i.e., annual) check and a means of identifying when a customer's circumstances change to a degree such that a fresh affordability assessment is appropriate. This might include, for example, when an overdraft facility is no longer covered by a customer's disposable monthly income. The key outcome should be to move away from a situation where many customers have an overdraft facility that is inappropriate for their financial circumstances, and where this becomes apparent only when the customer has developed substantial persistent overdraft debt.

- **Interventions at prescribed intervals to prompt consumers to change behaviour, remind those who have not responded, offer plan for repayment possibly with restructuring or suspension of facility.**

We strongly agree that banks should be required to intervene at prescribed intervals to support customers at risk of, or in, persistent overdraft debt. It is crucial that the first stage of intervention occurs before unsustainable debt accumulates. We consider it unlikely that most people who develop overdraft debt do so through conscious financial planning: the expense of overdraft fees is such that the majority of people would be better off pursuing alternative credit options and/or making adjustments to their budget.

There should be an early trigger point for an information intervention, such as when a customer begins to use an overdraft more often than not (for example, in any two of the last three months, or four of the last six months). This information should consist at a minimum of a reminder that overdrafts are designed for short-term emergency use, information about fees, an offer of advice from the bank and a referral to the availability of free debt advice. A preventative approach inevitably means providing information to more people than will in practice experience persistent overdraft debt.

A second stage of intervention should consist of advice and support for customers who show signs of becoming heavy overdraft users. This advice should consist of a discussion about the consequences of continuing to use an overdraft and an offer of alternative options where these are appropriate, including reducing an overdraft facility or alternative forms of credit. Appropriate triggers for this intervention might be utilising a high proportion of an overdraft facility over an extended period or ever using an unauthorised overdraft.

The final stage of intervention should be early forbearance. An affordability assessment should be triggered by any repeat use of an unauthorised overdraft, an extended period in which an overdraft is fully utilised, as well as any wider circumstances of which a firm is aware that mean it is unlikely a customer will be able to repay without significant detriment. Following an affordability assessment banks should, where appropriate, apply early forbearance including separating debt, turning overdraft debt into a low cost personal loan and freezing interest rates and charges. Some customers will not require forbearance but it is crucial that intervention is shaped by a customer's wider financial circumstances and the affordability of their debt: customers should not be required to reach a point of severe difficulty or crisis and seek debt advice before advice, support and forbearance is triggered.

- **Cost tapering or stepping, potentially to zero.**

As notes, we believe the FCA should decisively remove the incentive for banks to tacitly foster repeat and persistent overdraft use because fees and profit accumulate in excess of the costs of forbearance for a minority of users. This means that customers should ultimately stop paying charges on a negative balance. To achieve this, a cap should be placed on overdraft charges that operates on a monthly and cumulative basis. In addition to a fixed monthly cap on fees set by the FCA, a further cap should be set for an extended period such as each year: each month of fees would accumulate against this annual cap (if a customer paid an overdraft fee in a first and third month but not the second month, these fees would be linked and accumulate against the cap). The cap period would revolve beginning from the first instance of overdraft use. We recognise that there are difficult design questions involved in developing a cap and would encourage the FCA to assess the relative impact of options including this monthly/cumulative approach.

- **Removing or reducing an overdraft facility.**

  The decision to remove or reduce an overdraft facility should be based on a customer's individual circumstances and we would not suggest a hard trigger point laid in FCA rules. However, we agree that it would be helpful to make reference to the need to consider these options alongside mandated interventions where doing so is in the interests of the customer. In general, an overdraft facility is typically reduced in tandem with debt relief and a repayment plan. We presume that if banks were to put in place more effective systems to identify customers at risk of persistent overdraft debt, they will become more effective at matching an overdraft facility to a customer's needs, which may include reducing an overdraft facility without a customer necessarily having first experienced persistent overdraft debt.

Q16: Are there other remedies we could consider? Please explain what the impact might be, why such remedies would be appropriate, and any evidence you have to support your views.

We continue to believe that the FCA should investigate overdraft lending practice in the light of evidence that customers are routinely provided with an inappropriately large overdraft facility that subsequently becomes difficult to manage. The FCA's proposals to simplify overdraft fees will not address this problem. Nor does overdraft lending appear to have been address substantively as part of the FCA's recent work on assessing creditworthiness in consumer credit. Unfortunately, this seems to mean that an opportunity has been missed to address a root cause of the difficulties some customers experience with overdrafts.

One reason overdraft lending practice is problematic is the continuing ambiguity over what an overdraft is for and, following from this, what is a reasonable period in which people should be able to repay an overdraft. Different approaches to lending are appropriate depending on the nature of product. Overdrafts are a unique, permanent credit facility that pose special creditworthiness assessment challenges. A good starting point would be for the FCA to work with the public, banks and other stakeholders to develop a simple, proportionate creditworthiness framework for overdrafts which should be used to guide lending decisions, including the regular review of a customer's overdraft facility.

We would also like to see the FCA develop opt-in rules for PCA overdrafts. Proactively choosing credit means that people are more likely to engage with the product they are purchasing and its characteristics. At present, customers rarely actually apply (or are aware that they have implicitly applied in opening an account) for an overdraft. An op-in requirement would give people a chance to identify where an overdraft offered by a lender could prove problematic and decline the facility or request a reduced overdraft. An opt-in structure would also effect lender behaviour in the sense that banks would need to be able to show more clearly how an overdraft facility is linked to a customer's individual circumstances. Broadly, we would like to see a shift in practice and culture surrounding overdrafts so that customers are in control of the credit they use and overdrafts are extended by banks to the extent that they are a useful flexibility for customers.

Q17: Do you have any comments on our cost benefit analysis?

We have no comment at this time.

Q18: Do you have any views on the outcome of our EIA or the equality and diversity implications of the issues set out in this paper?

We have no comment at this time.