

Regulating the credit card market: why we need a cap on costs¹

End the Debt Trap Campaign briefing

Summary

The UK is in the grip of a consumer debt crisis. As at April this year, households owed a staggering £217 billion; the highest level on record and greater than prior to the Financial Crisis of 2008. This figure excludes mortgages and student loans.

The burden of consumer debt falls disproportionately on the shoulders of poorer households. Almost half of those spending more than one-quarter of their income on debt repayments – the threshold for what is considered ‘over-indebtedness’ – earn less than £15,000.

Around one-third (£72.4 billion) of all consumer debt is due to credit card use. While some pay off their credit card debts before they incur interest and charges, it is people on lower incomes that are borrowing more on their credit cards in proportion to their income and for longer. Credit card debt has grown by 25% in the past five years and this has outstripped income growth over that period.

Despite having conducted a two-year study of the credit card market between 2014 and 2016, the Financial Conduct Authority (‘FCA’) did not gather analysis of the uses of credit cards by income group. That is a major failing and obscures the clear picture that might lead to more effective policy interventions.

This report presents new evidence of the impact of credit card debt on low income households. On behalf of the End the Debt Trap Coalition, the Centre for Responsible Credit (‘CfRC’) has analysed data from the Bank of England’s 2018 Household Survey. This shows that:

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- One-third of all credit card borrowers have a balance that they cannot clear at the end of the month.
- 18% are incurring debts on their credit cards to pay for food or other living costs and a further 12% to meet an unplanned emergency expense such as car repairs.
- The percentage of people using their cards for these purposes increases to 40% among those living in households with pre-tax incomes of less than £15,000.
- A further 20% of low-income credit card borrowers used their credit card to refinance existing credit card borrowing or to pay off other types of debt.
- The credit card debts of these low-income borrowers averaged £2,900; 68 percent of their total consumer credit debt of £4,250.
- These borrowers have an average total debt to income ratio of 50 percent, and their average credit card debt to income ratio is 34%.
- Although some low-income credit card borrowers take advantage of temporary interest free offers, most are paying interest on their debts, and around one-quarter are making only the minimum payments on interest bearing accounts each month.

Credit cards can be an extremely expensive way to borrow. Recent years have seen an expansion of cards targeted at people with poorer credit ratings. These cards charge interest rates of up to almost 80% per annum. Low income households using these cards to cover basic expenses or to ride out crises can end up borrowing for long periods and are paying extortionate levels of interest and charges; paying back two to three times the amount that they originally borrowed.

Following its review of the credit card market, the FCA introduced new 'persistent credit card debt' rules in February 2018. These were aimed at preventing the build-up of interest and charges over time due to inadequate repayment levels. The rules require lenders to contact borrowers to invite them to increase repayments so that the principal sum is reduced more quickly.

However, this approach puts the onus on households that may already be struggling to meet basic outgoings. The FCA has not published any analysis to

indicate how many lower income credit card borrowers it expects to be able to afford higher repayments, and what the consequences will be if, under pressure from their lenders, their repayments are increased.

The FCA's new rules also fail to prevent borrowers from paying back more in interest and fees than they originally borrowed. Credit cards will, in some circumstances, remain more expensive than payday loans. Despite recognising that the payday loan cap, introduced in 2015, has been successful, the FCA continues to brush aside calls for a similar cap in the credit card market. It does so without ever having looked in detail at how one could benefit borrowers in this market. In our view, this is a clear regulatory failure and a dereliction of its consumer protection responsibilities.

Although the FCA introduced a cap on payday loan costs in 2015, it did not do so of its own volition. It was forced to do so by Parliament, and pressure is again needed to make it use its price-capping powers now.

To address the problem of high cost and persistent credit card debt, we call for the FCA to immediately introduce a rule that no credit card lender can charge a total cost (i.e. interest, fees and any other charges) of more than 100% of the amount borrowed. This should be implemented alongside, not instead of, its recent 'persistent credit card' debt rules.

The FCA should also conduct an immediate review of lending practice in response to its persistent debt remedies, including an analysis of how lenders are prompting customers to increase their payments and whether these increases are genuinely affordable.

If the FCA is unwilling to take these steps itself, then it should be formally requested to do so by HM Treasury.

If HM Treasury is unwilling to make that request, then MPs in the Treasury Select Committee and Parliamentarians more generally should take steps to address the regulatory failure that exists.

The build-up of household debt is a growing crisis and the use of credit cards is a very significant part of this. While access to credit is crucial to most people, it is neither morally right nor economically intelligent to permit lenders to target those on lower incomes with very high rates of interest in order to extract large profits. To

end the debt trap, the coalition is calling for a total cost cap on all types of consumer credit.

Britain's Household Debt Crisis

Britain is in the grip of an urgent household debt crisis. Between eight and ten million people are now over-indebted¹; spending more than a quarter of their income on consumer credit² repayments. This over-indebtedness is particularly concentrated in households with incomes of less than £30,000 per year.

In the past six years consumer credit debt levels have increased by nearly 40%. As at April this year households owed a staggering £217 billion to their lenders. This level of consumer credit debt is the highest on record; greater even than that witnessed at the time of the financial crisis³.

If this debt were to be evenly split across the population, every adult⁴ would owe just over £4,000. But the burden of debt does not fall evenly. Research by the Financial Conduct Authority ('FCA') in 2017 found that consumer credit use is concentrated within 45% of the adult population⁵. And study after study has indicated that the greatest debt burdens fall on lower-income, working age households living in rented accommodation⁶. Just under half (44%) of all households spending more than a quarter of their income on debt repayments have incomes of less than £15,000 per year.

But problem debt affects more than just the poorest. With weak regulations governing how money is lent; welfare changes and cuts impacting on those both in and out of work; a decline in real wages⁷, and a growth in underemployment and precarious work, millions are now becoming ensnared in the debt trap. The debt advice charity, StepChange has reported that as many as 15 million people (one in four adults in the UK) are showing signs of financial difficulty such as falling behind on bills, using credit to survive until payday, and borrowing more to refinance or 'roll over' previous debt or to maintain repayments on pre-existing agreements⁸.

The scale of household debt problems, and the increased 'rolling over' of debt that is taking place, is posing a risk to the wider economy and to local businesses and communities. This is because households are paying more interest on interest –

borrowing more and repaying more just to stand still. Much of the recent expansion of credit has not fed through into economic growth but has been extracted from the economy by the financial services sector as a means of restoring bank balance sheets in the wake of the financial crisis⁹.

The debt trap also has severe human consequences: contributing to increased poverty, deprivation, stress, and anxiety. The physical and mental health of families in debt suffer, with around one quarter of the 23,000 people admitted to hospital with mental illness estimated to be grappling with financial problems¹⁰. Debt also impacts negatively on relationships and working lives¹¹, with knock-on effects on community wellbeing and cohesion¹².

Caught in the Debt Trap

People become trapped in debt when it is both severe (because the repayments are high relative to the borrower's disposable income) and persistent (because the total debt owed is also high relative to disposable income).

The affordability, or otherwise, of credit therefore needs to take four factors into account. These are:

- The total amount of debt owed;
 - The cost of credit (the level of interest and fees charged);
 - The duration of credit agreements (i.e. the time given for repayment);
- and
- The disposable income (income after housing and other essential living costs) of households.

As this briefing proceeds to explain, the FCA's recent intervention in the credit card market is failing to protect borrowers because it has not adequately considered how these factors interact to trap people in debt.

Whilst the FCA has acted to limit the duration of debt repayments, albeit to a still very lengthy seven years, it has failed to limit the total cost of credit that people pay over that period; and it has failed to consider the impact of encouraging higher 'minimum' payments from lower income borrowers on their ability to meet other,

essential, commitments. The FCA has also failed to curtail the continued refinancing of debt through the use of balance transfers.

The UK's Credit Card Market

The UK's credit card market is in danger of spiralling out of control. The Bank of England's latest figures show that households currently owe a total of £72.4 billion on their credit cards; this is a record high and approximately one-third of all household consumer debt.

Credit card debt is also growing at an alarming rate. It has increased by more than 25% in the past five years (figure 1¹³, below).

This growth in nominal credit card debt is now outstripping incomes by some considerable margin. In the past five years, nominal aggregate Gross Disposable Household Income has grown by just 14.7%¹⁴.

Not all of the £72.4 billion of recorded credit card debt bears interest; due to it either being subject to promotional 0% interest offers, or because people are paying off their credit card balances in full at the end of the month. However, in 2016 the FCA estimated that 42% of outstanding balances do incur interest, and that this debt burden falls on approximately 21 million credit card customers. On this basis, the average 'interest-bearing' credit card debt per customer would be just under £1500.

But the burden of credit card debt is not distributed evenly; with lower income households having higher credit card debt to income ratios than those higher up the income distribution. Despite having conducted a two-year study of the credit card market between 2014 and 2016, the FCA has not reported the distribution of credit card debt to income ratios. This is a major failing¹⁵. Nevertheless, the Centre for Responsible Credit ('CfRC') has conducted an analysis of the Bank of England's Household Debt Survey¹⁶ for the End the Debt Trap Coalition which indicates that credit cards are a major component of the debt trap, especially for those on lower incomes. It shows that:

- One-third of all credit card borrowers have a balance that they cannot clear at the end of the month and have incurred this by using their card either to pay

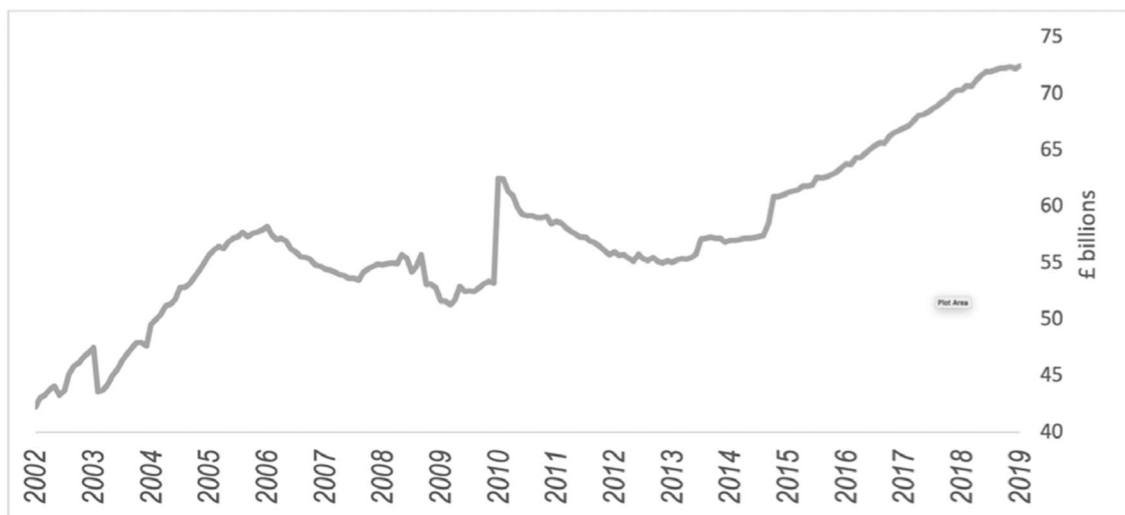
for food or other general day to day living costs (18%) or to meet an unplanned by emergency expense (15%) such as car repairs.

- The percentage of people using their cards for these purposes increases to 40% amongst those living in households with pre-tax incomes of less than £15,000. A further 20% of these low-income credit card borrowers used their credit card to refinance existing credit card borrowing or to pay off other types of debt.

- The credit card debts of these low-income borrowers averaged £2,900, and this formed 68% of their total consumer credit debt of £4,250. These borrowers have an average total debt to income ratio of 50%, and their average credit card debt to income ratio is 34%.

- Although some low-income credit card borrowers take advantage of temporary interest free offers, most are paying interest on their debts, and around one quarter are making only the minimum payments on interest bearing accounts each month.

Figure 1: Outstanding credit card debt, 2002 to 2019, £ billions



The High Cost of Credit Card Debt

Just as the amount of credit card debt has grown over the past seventeen years, so too has the cost of that debt. The Bank of England reports that the ‘representative’ interest rate for credit cards on accounts that bear interest¹⁷ is

around 20% per year; this is nearly 5% higher than it was at the time of the financial ,crisis.

Even discounting for that part of the outstanding debt which does not currently bear interest¹⁹, we estimate²⁰ that annual interest payments on credit card borrowing are at least £6 billion per year: an average of about £300 per year per borrower.

But the true cost of credit card debt for many borrowers is far greater than this. This is because many lower income borrowers pay a ‘poverty premium’ in terms of higher, ‘risk- based’, interest rates. In recent years, there has been an expansion of very high cost credit cards targeted to those on lower incomes with poor credit files. These include Vanquis Bank (owned by Provident Financial) which advertises credit cards with annual interest rates varying from 19.94% to 79.93%; and Aqua (owned by NewDay Ltd.) with rates between 35.95% and 59.95%.

Borrowing using these cards can be much more expensive than borrowing from a payday lender (where the total cost that can be charged has been capped at 100% of the amount borrowed since 2015). And, as this briefing proceeds to show, this remains the case despite the FCA’s recent actions.

Figure 2: Monthly interest rate of ‘representative credit card’ interest rates (2004 to 2019)¹⁸



What action has the FCA taken?

Concluding its credit card market study in 2016 the Financial Conduct Authority (FCA) identified that 5.6 million people were in 'persistent debt': these were either in arrears with payments; had defaulted, held a balance of above 90% of their credit limit for at least one year, or were repeatedly making minimum payments on their credit card debt.

Although the FCA did not expressly say so in its report, we calculate the percentage of credit card borrowers in persistent debt (on these measures) to be about one quarter (26%) of all credit card borrowers who incur any interest at all on their cards.

Following consultation, the FCA unveiled a set of new rules in February 2018. These came into effect in March that year although lenders were given until 1st September 2018 to comply. The FCA has indicated that it does not expect to review the operation of these rules until 2022 or 2023²¹.

What are the FCA's persistent credit card debt rules?

To address the problem of 'persistent credit card debt' the FCA now requires lenders to identify borrowers who, in any period of 18 months, have paid more in interest, fees and charges than they have paid off the principal (i.e. the amount they have drawn down or borrowed on the card). The FCA identified that customers in this position were paying an average of £2.50 in interest and charges for every £1 that they had borrowed in an 18 months period.

The FCA's new rules require credit card lenders to make a rolling assessment of the amount of interest and fees charged relative to the amount of principal repaid in the preceding 18-month period, and:

- If, in any 18 months period of using their card, the borrower has paid more in interest and fees than they have managed to pay off the principal then lenders are required to contact the borrower, and prompt them to increase their monthly payments. At this point, lenders are also required to make borrowers aware that, if they do not change their repayment behaviour, their card may be suspended and to provide borrowers with the contact details for debt advice services.

- If payments have not been increased after a further nine months, and borrowers are still likely to have paid more in interest and fees than they have from the principal after 36 months then lenders need to contact the customer again.

- Finally, if after 36 months the payments in respect of interest and fees are still more than the borrower has paid off in terms of the principal then lenders are required to offer the borrower a way to repay their balance within a 'reasonable period'. The FCA has stated that this further 'reasonable period' should be interpreted as between three or four more years, although it can be longer than this in 'exceptional' cases. To enable the debt to be cleared within this time-frame, the FCA requires lenders to show 'forbearance', which may, but does not have to, include waiving or cancelling any interest, fees, or charges.

In putting forward these rules, the FCA considered that many borrowers could afford to make more than the minimum repayments on their debts but were not doing so²².

If borrowers could therefore be successfully prompted to pay more each month, then this would reduce the overall amount of interest that people paid and reduce the length of time that they were in debt. However, it failed to put forward an analysis showing how many borrowers were making minimum payments because this was all that they could afford to pay.

It should also be noted that borrowers can slip in and out of the definition of 'persistent debt' over the course of their credit card agreements. In its Policy Statement the FCA gave the example of:

"...a customer in persistent debt who receives an 18 month and 27 month communication from the firm after which they increase repayments or make a lump sum payment sufficient to have taken them out of persistent debt at the next assessment period (the 36 months stage). The customer could then be identified by the firm as being in persistent debt again (because, for example they have reverted to their low repayment behaviour), in which case the persistent debt interventions at 18 months would start again."

Where this happens the FCA rules permit lenders to 'restart the clock'²³; accepting only minimum payments again for another 18 months before prompting

higher payments.

The problem with the FCA's approach

It is clearly true that making higher regular payments towards outstanding credit card debt reduces the principal owed more quickly and hence the total interest that people pay. However, the FCA has failed to properly consider whether borrowers will, in fact, be able to make higher payments and the new rules do not stop people from paying back more in interest and fees than they would on a payday loan.

Can people afford the higher minimum payments?

Prior to the introduction of the FCA's new rules someone taking out an Aqua card; using this to make purchases of £350 in the first month and then making only the minimum monthly payments thereafter would take over 11 years to clear the debt. During this time, they would have paid over £1,000 in interest²⁴; nearly three times as much as they would with a payday loan.

The total cost arises because the Aqua card charges a high level of interest (as much as 3.99% per month) and also requires a minimum payment of just the monthly interest plus 1% of the outstanding balance. On a balance of £350 the minimum payment starts at just £22 per month, but this reduces as payments are made, stretching the loan duration out over many years.

Under the new rules, if this borrower made only minimum payments for the first 27 months, they would then need to be 'prompted' by their lender to more than double their monthly payments. This would then meet the FCA's requirement that the borrower had paid more off the principal than they had in interest and fees after having the card for 36 months.

The question arises as to whether such borrowers can afford a doubling of their minimum repayments? The FCA did not undertake any detailed analysis as part of its market study to answer this question.

Despite this failure we do know, from previous studies of other types of consumer credit debt, that many households hold a variety of different types of debt in combination. For example, the FCA has previously reported:

- There are approximately 1.6 million people using payday lenders and that nearly two-thirds of these are over-indebted²⁵;

- These borrowers typically owe a total, across all forms of consumer credit debt of £3,600; and

- Payday loans account for about £360 of this and credit card debts about £720. Personal loans and car loans make up much of the remainder. In our view it is highly unlikely that borrowers such as these can afford an increase in their minimum payments. If they are contacted by their lenders with threats that their cards will be suspended unless they increase their payments, and divert more of their income to this, then this will limit their ability to service their other debts; meet essential living costs and pay household bills.

Much depends on exactly what form of ‘prompt’ people receive and how borrowers respond to the threat of their cards being suspended if they do not pay more. Whilst the FCA’s general rules require credit card lenders to consider the affordability of payments, there are longstanding concerns that these are not being followed in this sector.

For example, the Financial Ombudsman Service recently upheld a complaint about “irresponsible” lending in respect of Vanquis Bank²⁶. This centred around the lender’s common practice of ‘stepping up’ borrower credit limits from initially very small amounts (in this case just £250) to much higher levels despite having clear evidence that customers are struggling with repayments. In the case in question, Vanquis increased the credit limit on the account for the customer (‘Miss R’) to £2,000 and justified this on the basis that she had been making her minimum repayments, and sometimes more than this.

However, the Ombudsman found that the credit limit increase was irresponsible:

“Immediately after Vanquis increased Miss R’s credit limit...Miss R’s spending increased, and her balance increased to near to the account limit. She occasionally exceeded this limit and there does not appear to have been any significant period when the balance decreased. In my view this changes the picture of Miss R’s borrowing available to Vanquis and demonstrates that she was no longer managing the account reasonably well. At the time of the increase...to £2000 Vanquis also carried out a further [credit] search which revealed nearly £1000 of non-

mortgage debt elsewhere. In the context of her declared income, debt elsewhere, and that her balance on the account had increased and remained high, I agree with the adjudicator that this decision to increase Miss R's limit was irresponsible."

The case illustrates how individual credit card lenders consider the concept of 'affordability' in an extremely narrow sense; overly focusing on whether the borrower is making the minimum payments asked of them and failing to adequately assess their wider financial circumstances, including their debts to other lenders. In short, lenders appear more concerned with whether someone is paying them back than with whether they can genuinely afford to do so.

Further to this, and only one month after the FCA introduced its persistent credit card debt rules, Stella Creasy MP reported to the Treasury and the FCA that New Day Ltd. was writing to its Aqua credit card borrowers to inform them that their minimum payments would automatically be increased unless they contacted it to 'opt out'. Given that many borrowers in financial difficulties may be fearful of contacting their lenders, this increases the likelihood that they will be required to make payments that they cannot afford, with knock-on consequences for their ability to make ends meet and pay other bills.

In view of this, we call on the FCA to conduct an immediate review of how lenders have thus far responded to its persistent credit card debt rules; to gather information and report on the steps that credit card lenders are taking to ensure that any requested increase in repayments are genuinely affordable for borrowers.

Whilst such a review would provide policy-makers with greater transparency concerning the immediate consequences of the FCA's rules, it would not, however, address the credit card debt trap that still exists for many borrowers. This is because, the FCA's rules fail to place a limit on the overall cost of credit and do not address the problem of refinancing, or 'rolling over', of credit card debt.

Credit cards can still cost more than payday loans

The FCA's rules encourage higher repayments to be requested by each credit card lender (whether affordable or not) with the aim of reducing the time that borrowers will take to clear their debt. Whilst this has the effect of reducing the total

interest that is paid by borrowers, it is still possible for borrowers to pay extortionate costs for their credit. This is because the interest rates of some credit cards are extremely high and there is a lack of clarity as to what precise forbearance the lender must put in place after 36 months.

For example, the highest charges made by Aqua are 3.992% per month (59.9% APR) in respect of purchases, and 4.519% per month (69.95% APR) for cash advances. Someone making £350 of purchases on this card and making only the minimum payments will have made payments totalling £530 at the 36-month point. Of this amount, £420 will have been taken in interest, and the borrower will still have an outstanding balance of £240. At this point, the minimum payment required of the borrower would be about £12 per month.

The FCA's rules then require the lender to agree a repayment plan which will ensure that the borrower can clear the debt within a three to four-year period.

To comply with this rule, Aqua is not required to reduce the interest rate on the account. It could reduce the minimum payments by a nominal amount and hold these constant for the next three years. For example, if repayments were set at a constant £11.50 per month this would pay off the remaining debt within four years, but also allow Aqua to charge a further £287 in interest. The total interest charged on the £350 originally borrowed would therefore be £707 and the total amount repaid would be over £1,000: more than twice the cost of a post cost cap payday loan.

These eye-watering costs for credit cards are being paid by at least hundreds of thousands, and perhaps millions of borrowers.

After a two-year market study, the FCA has been unable to say precisely how many are in this position. The FCA did undertake an exercise to calculate the ratio of total interest and charges to the value of transactions (e.g. purchases and cash withdrawals) incurred by credit card accounts between January 2010 and January 2015. This revealed that just under 300,000 customers had paid a cost of credit of more than 100% over that period²⁷. However, the FCA did not report on the level of outstanding balance that remained at this point and itself recognises that the figure of 300,000 is therefore an under-estimate²⁸.

“It is important to recognise that the cost of credit...reflects only the observed costs that have accrued on the account to date. However, no allowance is taken for the size of the outstanding balance at the end of the sample or the length of time it is expected to pay-off this balance which will result in costs in the future. These cost calculations will therefore underestimate the full costs which are likely to accrue on the account, particularly for those accounts that are carrying a significant balance at the endpoint of the data.”

Whilst the numbers of people who have paid a total cost of credit of more than 100% in recent years are unknown, we do know that many will continue to pay more than this despite the FCA’s rules.

The FCA’s rules may encourage borrowers to continually refinance their debt

It is also likely that the FCA’s rules will have the unintended effect of encouraging borrowers to continually refinance their debt.

The FCA’s market study found that around £14 billion of credit card debt in 2014 was held in accounts that had been opened as a result of a balance transfer. Although the study found that most balance transfers were paid off in full before the end of the interest-free period, it also found that around 20% of people who had transferred a balance in 2014 had also done so in either 2012 or 2013.

The FCA also recognised that the threat of having their cards suspended at the 18-month intervention point might encourage borrowers to transfer their debts to other cards at that point, with potentially serious implications²⁹:

“Instead of engaging with the credit card provider, some customers may decide to refinance their debt through either a balance transfer or consolidation of the balance through a personal loan...A balance transfer may also allow the accountholder to defer dealing with unaffordable debt. If the existing credit card is retained it may also increase the available credit to the borrower and so could increase the overall debt burden. Some customers could also turn to alternative, potentially higher cost, forms of credit or sacrifice essential expenditure, such as utility bills, in order to increase their credit card repayments in response to the prospect of the suspension of

borrowing. However, as such a suspension is far from certain, and the remedy requires that firms encourage customers to contact them in case higher repayments are unaffordable, we do not expect many of customers to react this way...

In our view, the FCA has failed to analyse the extent of this problem and hence understand the full impact of its actions. Its assumptions should be tested empirically. Close monitoring of the actual effects of the FCA's rules are required and a detailed review cannot wait until 2022 or 2023, as the regulator has proposed.

Why has the FCA rejected a cap on credit card costs?

Throughout the consultation on its credit card rules, the FCA faced calls from consumer groups to cap the total cost of credit card borrowing at 100% (the same level as applies to payday lenders). This call was supported by the FCA's own Consumer Panel. In their submission to the FCA they said³⁰:

"The FCA said [it's] 'preferred approach is typically preventative – to stop bad things from happening in the future'. The proposals will not achieve this. The FCA's definition means that people in persistent debt are "typically paying approximately £2.50 in interest and charges for every pound of their balance they repay" on each account. This can go on for three years before the lender is required to take any real action, by which time the cardholder could be in debt on a number of cards, and with household bills... It is extraordinary that the FCA put a price cap on high-cost short-term credit "to protect consumers from excessive charges" but does not even comment on whether paying £2.50 in interest and charges for every £1 capital repaid - over an extended period - is excessive or not. We continue to urge the FCA to adopt a consistent approach to regulation across all credit products."

The FCA brushed aside these calls, arguing that its rules:

- Are more likely to address problems of persistent debt;
- Will help customers deal with problem debt "more quickly" and avoid "paying out so much in interest and charges"; and that
- It is not practical to implement a cap on credit cards because they are a form of revolving credit.

We do not agree with the FCA in any of these respects. But, perhaps more importantly, the FCA has provided no evidence whatever to support its arguments.

- The FCA has not published the findings of any modelling to determine whether a cap on credit card costs would have a greater impact on the problem of persistent debt or not. But, there is also no reason why its persistent debt rules could not be combined with a cap of 100% on credit costs. If this were to be done, then the cap would act as a backstop such that no-one would ever pay more on a credit card than they would if they borrowed from a payday lender.

- Whilst the persistent debt rules could reduce the amount of interest and charges that people pay, there has been no analysis presented which shows that borrowers will pay less interest and charges than they would if there was also a 'backstop' cap on those costs. As the analysis in this briefing shows, under the FCA's rules it is entirely possible that borrowers will continue to pay much more in interest and charges than they borrowed.

The FCA has also not publicly explained why it would be difficult to impose a cap on revolving credit agreements. The very rules that it has put in place show that it is possible to implement a cap; as they require lenders to assess the total interest and fees charged on a rolling basis and compare this to the amount that has been paid off the principal.

It is therefore straightforward for lenders to identify when a borrower has paid more than 100% of what they have borrowed in interest and other charges. Indeed, as part of its market study the FCA itself conducted an exercise to calculate total interest paid on credit card accounts as a ratio of the total level of transactions. And, since 2012, the industry has also been providing borrowers with annual statements which³¹:

"...specify the time period covered and include total spending, the amount repaid, and any interest fees and charges incurred. The statement also shows exactly how the card has been used during the year - broken down by point-of-sale spending, cash advances, balance transfers, and the applicable interest fees and charges for each of these types of transaction. Information will also be provided on charges for foreign transactions."

The FCA is failing customers

In our view, the FCA is derelict in its duty to protect borrowers in financial difficulties in the credit card market.

- It's analysis of the problem failed to consider the incomes of borrowers, or their overall level of indebtedness.

- The rules, combined with the poor quality of affordability assessments in this sector, risk pushing lower income borrowers into paying more than they can afford, with knock-on impacts on their ability to make ends meet and pay other household bills. Despite this the FCA is not proposing to undertake a review of responses to its rules until 2022 at the earliest.

- The rules still provide credit card lenders with the opportunity to charge excessive interest and fees: in many cases, more than double the cost of a payday loan. This is because there is no cap on costs, and no requirement that lenders freeze interest at the 36-month intervention point.

- The rules also provide a 'loop-hole' for lenders to avoid helping people in persistent debt. This is because if, in any 18-month period, one penny more has been paid off the principal than in interest and charges then the 'clock is restarted'. This also applies were borrowers refinance their agreements through a balance transfer.

- The FCA has brushed aside calls by consumer groups for a cap on the total cost of credit card lending, without having conducted any serious research into this possible remedy. Yet, the cap on payday lending – introduced in 2015 – has by the FCA's own admission been very successful in delivering fairer costs to borrowers and improving lending practice.

The reality is that the FCA's intervention in the credit card market amounts to a 'regulatory failure'. Although the FCA has successfully imposed a cap on payday lending, it was forced by Parliament to do so. If we are to address problems in the credit card market, then Parliamentary intervention will again be needed.

Our Recommendations

To address the problem of high cost and persistent credit card debt, the FCA should immediately introduce a rule that no credit card lender can charge a total cost (i.e interest, fees or any other charges) of more than 100% of the amount

borrowed. This should be implemented alongside the current persistent debt rules, which should be retained.

The FCA should also conduct an immediate review of lending practice in response to its persistent debt remedies, including analysis of how lenders are prompting customers to increase their payments and whether these increases are genuinely affordable.

If the FCA is unwilling to take these steps, then it should be asked to do so by HM Treasury.

If HM Treasury is unwilling to do so, then MPs in the Treasury Select Committee and Parliamentarians more generally should take steps to address the regulatory failure that exists.

Endnotes

1 Using the methodology in 'Britain in the Red', TUC, 2016 and updated by Centre for Responsible Credit 2019, forthcoming.

2 The consumer credit market comprises personal loans, credit cards, hire purchase (e.g. car finance) and other unsecured lending including payday loans, door to door moneylending, and rent to own. It does not include mortgages or student finance.

3 Source: Series LPMBI2P, Bank of England. The previous peak in consumer credit borrowing recorded on this series was in September 2008 when the total stood at £209 billion.

4 There are an estimated 53.8 million adults (defined as aged 16 and over) living in the UK today. 'Population estimates for the UK, England and Wales, Scotland and Northern Ireland: mid-2018', Office for National Statistics, 26th June 2019.

5 The 'Financial Lives' Survey, (October 2017, Financial Conduct Authority) found that 46% of the UK's adult population were paying for consumer credit. This excludes people whose sole use of credit products are credit cards, store cards and catalogue credit, where they pay off the balance in full every month or most months.

6 See, for example, 'A Picture of Over-indebtedness', Money Advice Service, 2016 and 'Britain in the Red', TUC, 2016.

7 Real wages declined by 12% in the five years following the financial crisis, and despite a small pickup (of 2%) between 2013 and 2015, have been flatlining since. 'Analysis of real earnings and contributions to nominal earnings growth, Great Britain: September 2018', Office for National Statistics,

8 'Life on the Edge: Towards more resilient family finances', StepChange, 2014.

9 In the wake of the financial crisis banks cut interest rates for savers at a greater rate than they did so for borrowers. This has increased their margins on loans. For detailed analysis, see 'Financial intermediation services indirectly measured (FISIM) in the UK revisited', Office for

National Statistics, 24th April 2017

10 Research conducted by the Money and Mental Health Policy Institute, see <https://www.ft.com/content/75076c60-154e-11e8-9376-4a6390adb44>

11 Gibbons, D. (2010). Out of Work and Out of Money. Manchester City Council

12 This is because over-indebted households are geographically concentrated. See, for example, Gibbons, D. (2016), 'The distribution of consumer credit debt in Leicester', Community Investment Coalition.

13 Bank of England data series LPMVZRJ

14 Gross Disposable Household Income is the official measure of the amount of money that all of the individuals in the household sector have available for spending or saving after income distribution measures (for example, taxes, social contributions and benefits) have taken effect. Office for National Statistics, series QWND

15 During the course of its Credit Card Market Study the FCA claimed that it had no reliable source of income for credit card borrowers (Annex 6 to the Market Study, 2015). This is because credit card lenders do not routinely ask for this information. However, the FCA has conducted a major survey (the 'Financial Lives' survey of household debt) and could have included questions within this to fill this information gap. Other surveys, such as the Bank of England's Household Debt Survey (see following footnote) also contain details on both income levels and types of consumer credit debt, including credit card debts.

16 The Bank of England Household Debt Survey is conducted on the Bank's behalf by NMG Consulting. The last survey data relates to 2018, and the survey is based on approximately 6,000 responses. Analysis of this dataset has been conducted for the End the Debt Trap Coalition by the Centre for Responsible Credit.

17 The 'representative rate' therefore excludes balances on 0% promotional deals or balances which are cleared in full at the end of the month. It is based on credit cards that have higher usage and are available to most customers. From Q1 2019, products that are labelled as 'low rate', 'premium' or are exclusive to one profession or demographic - which tend to have more competitive rates - have also been excluded from the series.

18 Bank of England series IUMCCTL. The rates are the headline interest rates advertised by banks and building societies, which the Bank then weights using business volumes reported by those institutions

19 It should be noted that not all of the debt that does not currently bear interest will be paid off within the 0% promotional period and may become interest-bearing at a later date.

20 In 2016 the FCA estimated that 42% of the total amount of credit card debt at that time was 'interest-bearing' which, if still true today, would indicate that £30 billion of credit card debt is currently incurring interest. We apply the current representative interest rate of 20% to that figure.

21 Para 1.30 'Credit card market study: Persistent debt and earlier intervention - feedback to CP17/43 and final rules', Financial Conduct Authority, February 2018.

22 The possible reasons given for this by the FCA included that borrowers do not

understand that making only minimum payments can lead to very high overall interest payments, or that they do not actively review their payments – for example, they set up initial Direct Debits to make only the minimum payments and do not revisit this.

23 Para 2.16, 'Financial Conduct Authority Credit card market study: Persistent debt and earlier intervention – feedback to CP17/43 and final rules', Financial Conduct Authority, February 2018.

24 Based on the 'representative' quoted monthly interest rate of 2.592 from Aqua website as at 27th June 2019, and calculated using the Card Costs website established by UK Finance – see <https://www.cardcosts.org.uk/>

25 'Consumer credit — high-cost short-term credit lending data', Financial Conduct Authority, January 2019.

26 Financial Ombudsman Decision DRN9928394, dated 20th July 2018, available from <https://www.ombudsman-decisions.org.uk/>

27 Figure calculated by Centre for Responsible Credit from the percentages provided by the FCA in para 48, 'Credit Card Market Study Interim Report: Annex 6– Affordability analysis', Financial Conduct Authority, November 2015.

28 Para 49, Ibid.

29 Para 81, 'Credit card market study: consultation on persistent debt and earlier intervention remedies', Financial Conduct Authority, April 2017.

30 Financial Services Consumer Panel response to 'Credit card market study: consultation on persistent debt and earlier intervention remedies', 3rd July 2017.

31 UK Cards Association press statement announcing the introduction of annual statements, March 2012 (see http://www.theukcardsassociation.org.uk/wm_documents/UK%20Cards%20-%20Annual%20Statements%20-%20release%2028%20Mar%2012.pdf)

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