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Date: 15 February 2017
Response by: Which?

# Consultation Response

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## About Which?

Which? is the largest consumer organisation in the UK with more than 1.5 million members and supporters. We operate as an independent, a-political, social enterprise working for all consumers and funded solely by our commercial ventures. We receive no government money, public donations, or other fundraising income. Which?'s mission is to make individuals as powerful as the organisations they have to deal with in their daily lives, by empowering them to make informed decisions and by campaigning to make people's lives fairer, simpler and safer.

## Summary


- The Competition and Markets Authority (CMA) inquiry into personal current accounts failed to adequately address the consumer harm caused by unarranged overdraft charges.

- Following the FCA's tough approach to tackling unscrupulous practices in the payday loans market, we would like to see the FCA take a similarly strong approach to directly constrain unarranged overdraft charges.

- Which? proposes that unarranged overdraft charges should be set at the same level as arranged overdraft charges.

- This approach would allow banks to continue to set their own charge cap, but it would prevent them from targeting the most disengaged and financially vulnerable customers, who are least likely to switch, with disproportionately high punitive charges, as they would not be allowed to charge more than for an arranged overdraft.

- Constraining unarranged overdraft charges in this way does not need to have an adverse impact on consumer access to credit – if it had such an impact, it would be a bank's decision. Such a reaction would be extreme and unwarranted, and would

not accord with a consumer-focussed culture, based on treating customers fairly. In its consideration of overdraft charges, the FCA should assess how banks treat overdraft users.

- Which? recognises that stopping banks from differentiating the charging structures of arranged and unarranged overdraft may result in an slight overall increase of arranged overdraft charges. However, arranged overdraft users are more engaged are more likely to switch, and therefore exert competitive pressure on banks to keep these charges low.

- We do not consider it would be necessary for a bank to stop offering free-if-in-credit banking in reaction to the FCA constraining unarranged overdraft charges as Which? proposes. It would be an unpopular move with customers if a bank made this choice.

**Introduction**

Throughout the CMA's retail banking inquiry, Which? raised significant concerns with its proposed remedies for addressing the harm faced by heavy overdraft users. We remain unconvinced that the CMA's remedies will provide an effective means of addressing the identified harm. We set out our views in greater detail in our letter to Andrew Bailey on 7th July 2016, and we welcomed his response and the FCA's commitment to examine this issue further in the context of its work on high cost credit.

It is important that unarranged overdrafts are treated as a service that a bank offers, and that the terms upon which they are provided are judged in the context of alternative sources of 'emergency funds'. This context reflects the situation where a consumer faces an immediate need for access to additional funds, for cash withdrawals or payments to remain possible. Overdrafts provide a potential means of making up what would otherwise be a shortfall of funds. As such, they can serve the same purpose as other potential sources of emergency funds, such as payday loans.

The disparity between the FCA's approach to payday loans, and the CMA's proposals for tackling the detriment caused by unarranged overdrafts, needs to be addressed. Which? supported the FCA's strong action in the payday loan market and, given the parallels with the punitive high charges associated with unarranged overdrafts, advocates similarly strong action in this area. Which? proposes that measures are introduced to directly constrain charges for unarranged overdrafts. The approach proposed by Which? is that unarranged overdraft charges be set at the same level as arranged overdraft charges.

**Consumer detriment**

As detailed in the CMA's research, over half (51%) of overdraft users (and around 22% of all users) went into an unarranged overdraft at some point in 2014, demonstrating the scale of overdraft use. Alongside this, the regular use of unarranged overdrafts was notable, with 10% of unarranged overdraft users using this provision for nine months of the year or more.

The CMA indicates that around 9% of customers pay more than £20 per month in overdraft charges and around 2% of customers pay more than £60 per month, suggesting that some heavy overdraft users will have been paying hundreds of pounds per year in overdraft charges.

It also suggests that a significant number of consumers are using unarranged overdrafts as a form of high cost credit.

Excessively high unarranged overdraft fees cause significant consumer detriment to a group of consumers who are clearly identifiable as being financially vulnerable. This is evidence of a sector that does not have a culture of treating consumers fairly.

**The cost of unarranged overdrafts**

Which? research has showed that the cost of an unarranged overdraft can be over 15 times higher than that of an arranged overdraft. The disproportionate difference in cost between arranged and unarranged overdrafts raises significant concerns about the treatment of customers who are heavy overdraft users. These individuals are easily identifiable to their banks as being vulnerable and in financial difficulty due to their financial activity. However, the response of the banks appears to be to charge excessively high fees that cause significant detriment to this group of consumers. This clearly raises questions as to how banks are inculcating a culture of treating customers fairly.

The CMA found that heavy overdraft users are the least likely to switch, and as a result the banks have little financial incentive to compete on the level of charges. The CMA's remedies, however, focused heavily on improving competition and increasing levels of switching. Measures to improve switching are unlikely to comprehensively address the harm faced by unarranged overdraft users, when the CMA's own evidence implied that consumers in credit have low incentives to switch and heavy overdraft users are very unlikely or unable to switch, even with prompts.

It could be asked why unarranged overdrafts exist at all - the charges incurred appear to exist either to penalise those who need the extra overdraft facility, or to cover the costs to the bank of lending to these customers. However, if is the former we would question whether this is appropriate behaviour for banks dealing with vulnerable customers, and if it is the latter then evidently these costs are out of proportion. The lack of proportionality is highlighted by the fact that a consumer who repays their unarranged overdraft (and so shows themselves to be a 'good risk') is not then offered a better unarranged overdraft rate to reflect that reduced risk, but simply the same terms that other, riskier consumers get.

Which? welcomes the FCA's decision to consider overdrafts within its review of the High Cost Short Term Credit market, given that they can serve the same purpose as other potential sources of emergency funds, such as payday loans. However, Which? research found that the cost of an unarranged overdraft is disproportionately higher as a means of high cost short term credit than a payday loan.

The disparity between the FCA's High Cost Short Term credit price cap and the charges levied by banks for using an unarranged overdraft, needs to be addressed.

**The CMA's Monthly Maximum Charge remedy (MMC)**

The CMA's proposal to require personal current account providers to introduce a monthly maximum charge (MMC) covering all unarranged overdraft charges, is insufficient. Banks already typically put caps on the total amount of unarranged overdraft usage charges that can be incurred in a given month and the MMC will would do little to change the current situation.

Not only are banks able to continue to set their own caps, the CMA has stipulated in its Banking Order that overdraft charges will apply to the bank's monthly billing period, not the number of days the money is borrowed for. A customer with an unarranged overdraft which lasts 30 or 31 days could fall across two calendar months and voluntary cap would not apply as intended. Which? called for a more consumer-based perspective to deliver a clearer definition of 'month' for the purposes of the MMC, such as 'in any 30 day period', but this was not adopted by the CMA.

Paragraph 28.5.1 of the CMA's Retail Banking Market investigation order 2017 defines a 'month' as 'the provider's monthly charging period' for the purposes of the MMC. In practice, this means that consumers could face overall charge levels which greatly exceed the level of the defined MMC, and could be as high as double, in a given 30-day period. This could even occur within a given calendar month if the bank's monthly charging period does not align with calendar months. This is likely to be particularly confusing and costly for consumers.

For example, a bank may state that it charges £6 per day for the use of an unarranged overdraft, and that its Monthly Maximum Charge is £90. If the monthly charging period restarts on the 1st day of the month (and the MMC 'resets'), a customer who uses an unarranged overdraft from 17 January to 16 February could be charged £90 for January, plus a further £90 in February because the limit would be reset. The customer would only have used the unarranged overdraft for 31 days, the equivalent of one month, but could face £180 in charges, almost double the MMC stated by the bank despite having used the facility for a month. Which? is concerned that the customer's experience of using an unarranged overdraft for a month might result in them paying far more than they expect to, as a result of the CMA Order defining a month as the provider's monthly charging period.

Which? is not the only organisation to draw attention to the problems that arise from the use of 'month' without further clarity. The CMA itself commissioned research from Research Works who, in slide 52 of their *Presentation of qualitative research findings* said on this point: 'MONTHLY: Clearest and shortest option – assumed to indicate 'calendar month'', and 'The bank needs to clarify what 'monthly' means'. This clearly recognises the issue with leaving 'month' as a definition open to interpretation. Which? is concerned that the CMA's approach in this Order simply adopts the relevant bank's perspective of its chosen charging month period with little regard to the effect on consumers.

In order to assess how the CMA's Order could affect consumers, in February 2017 we carried out research to determine how much consumers could find themselves being charged by their bank. We compared the cost of borrowing £100 for 30 days and found that unarranged overdraft charges at some high street banks were as much as £156 more than a payday loan. Because bank overdraft charges apply to their monthly billing period, not the number of days the money is borrowed for, consumers who need £100 could pay up to £180 in fees if they borrow across two billing periods - 7.5 times higher than the maximum charge of £24 on a payday loan over the same period.

However, even if unarranged overdraft users are charged over a 30 consecutive day period for use of the facility, charges would still be as much as four times higher than the maximum charge that would be allowed on a payday loan. For borrowing over a shorter period, the multiple actually increases due to the charging structure – over 7 days an unarranged overdraft user could incur £70 in charges, 12.5 times more than the £5.60 a payday lender could charge.

## Tackling consumer detriment

It is unlikely that the CMA's proposed remedies will provide an effective means of addressing the detriment to heavy overdraft users that it identified. They put considerable reliance on pressures from switching in a context where the CMA found heavy overdraft users to have been much less likely than average to switch, despite having had much greater financial incentives to do so.

In order to effectively tackle the consumer detriment, the FCA should introduce measures to directly constrain charges for unarranged overdrafts. The approach proposed by Which? is that unarranged overdraft charges be set at the same level as arranged overdraft charges.

This approach would allow banks to continue to set their own charge cap, but it would prevent them from targeting the most disengaged and financially vulnerable customers, who are least likely to switch, with disproportionately high punitive charges, as they would not be allowed to charge more than for an arranged overdraft.

## Access to credit

It is important that the FCA undertakes detailed assessment of the consequences for implementing a charge cap, and the impact it might have on the provision of credit.

The current approach of the banks, which is to charge excessively high unarranged overdraft fees to a group of consumers who are clearly identifiable as being financially vulnerable, is evidence of a sector that does not have a culture of treating consumers fairly.

In response to a regulatory cap on these charges, a bank's response might be simply to deny access to credit to these consumers. However this reaction would be a bank's decision, not an inevitable result of our proposal – and in any case would be extreme and unwarranted, and would not accord with a consumer-focussed culture, centred around treating customers fairly.

## Cost of arranged overdrafts and in credit banking

Another consequence of implementing a regulatory cap could be that banks choose to increase the cost of arranged overdrafts. However, arranged overdraft users are more engaged are more likely to be engaged and are more likely to switch. They are therefore in a better position to exert competitive pressure in this environment, putting pressure on banks to keep these charges low. The CMA's remedies to improve switching will also help drive competition for this group of consumers.

Finally, in an extreme case banks could choose to stop offering free-if-in-credit banking. Free-if-in-credit banking is hugely popular with customers and, as such, it would be an exceptionally unpopular response if a bank chose to end this service for its customers. In any case, the CMA's measures to improve competition in retail banking may also make it a very difficult commercial decision for the first bank to do so. It would represent a significant shift in the market, but would increase transparency regarding how much all customers pay for their accounts, albeit currently in different ways. Which? has long argued that free banking is a myth.

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