MONEY AND MENTAL HEALTH
POLICY INSTITUTE

Response to the FCA's High-Cost Credit call for input

Introduction

Money and Mental Health welcomes the opportunity to respond to the FCA's call for input on High-Cost Credit.

Our research shows that mental health problems can change the ways consumers interact with credit markets, increasing the risk of harm.[1] At the same time, consumers experiencing mental health problems may have experienced other life events such as bereavement or relationship breakdown, which lead to expenditure shocks, or may be managing on a lower income if their illness leaves them unable to work. Together, these factors are leaving millions of consumers in financial difficulty, often because of experiences using high-cost credit. People with mental health problems are significantly more likely to be in arrears on high-cost credit products than those without.[2]

*W*e believe that the FCA should work to ensure that markets work well for all consumers, including the quarter of UK adults - equivalent to 11.8 million people - experiencing a mental health problem at all given time.[3]

Money and Mental Health focuses, as a policy institute, on building the evidence base for pragmatic policy change to break the link between financial difficulty and mental health problems. We do not provide advice or guidance to people experiencing mental health problems or financial difficulty, and as such our response focuses on the wider issues around high-cost credit and overdrafts, specifically questions 1-8 of the call for input.

High-cost credit: wider issues

Q1: Which high-cost products do you think our review should focus on and do you think a more consistent approach to high-cost products is feasible or desirable?

We believe that looking across the market at different types of high-cost credit products is the right approach, and are encouraged by the completeness of the lists the FCA has

[1] Murray, N, Holkar, M, Mackenzie, P. 'In Control' a consultation on regulating spending in periods of poor mental health. Money and Mental Health Policy Institute. 2016.
[2] Jenkins R et al. Debt, income and mental disorder in the general population, Psychological Medicine 2008; 38: 1485-1494.
[3] Money and Mental Health analysis, using ONS 2015 mid-year population estimates and McManus et al, Adult psychiatric morbidity in England, 2007 Results of a household survey, NHS Information Centre for Health and Social Care 2008.

included in this review: payday loans, home credit, catalogue credit, rent-to-own, pawnbroking, guarantor, logbook loans, credit cards, overdrafts and installment loans.

Similar customer demographics

Although the FCA is right to recognise that this review encompasses a wide range of products, some of which have specific purposes (e.g. hire-purchase) and some of which are more mainstream (e.g. overdrafts, credit cards), these products are broadly used by a similar group of customers which means a unified approach is beneficial. Only with this extended remit will the FCA be able to minimise opportunities for regulatory arbitrage by credit providers and substantially reduce consumer harm. Consumers who are relying on high-cost credit products are likely to be facing other challenges in life too - living on a low or variable income, experiencing a mental health problem, they are more likely to be renting and to have dependent children.

When juggling all these competing priorities, engaging actively with the credit market and exercising informed choice about which product is best and which provider offers the best value, won't always be feasible. Cost is unlikely to be the sole factor in a consumer's decision - availability, speed and convenience may all be more important. A single parent with three small children and a broken boiler in a February freeze probably may simply not have time or energy to consider whether it's more effective to borrow through an overdraft, a payday loan or hire-purchase. It's therefore essential that the regulator steps in to provide a minimum level of protection for these customers in vulnerable circumstances, regardless of the credit products they choose and ensures that creditors are not able to derive excess profits from consumers who are unable to engage with the market and find a better deal.

Common features of high-cost credit products

The products identified by the FCA are all higher-cost as a result of the risk associated with lending to consumers on low or variable incomes, or to consumers with thin or poor credit histories. However these products also share more worrying features. In particular, high-cost credit products share a range of problems around price transparency and bundling which make it difficult for consumers to reach informed decisions about the cost of credit and choose wisely. Unauthorised overdrafts, for example, are sold as part of a broader current account package which makes it difficult for consumers to identify the costs of this type of lending. These charges are not the focal point of their decision-making process, rather they will tend to spend more time looking at more proximate features of a current account, like whether it will meet their day-to-day spending needs. Similarly, when buying furniture on hire-purchase or clothing through a catalogue, the consumer is likely to be focusing on the end product, not on the cost of credit. In each of these product cases we see a similar lack of transparency around the pricing of credit which makes it difficult for the consumer to engage with this cost, and means there may not be an appropriate trigger to seek credit from other, potentially cheaper, sources as an alternative. These common problems around price transparency and bundling means it makes sense to consider the market for high-cost credit as a whole and develop cross-market solutions which really work for consumers.

Inconsistent affordability assessment
There are also, at present, problematic inconsistencies in how the affordability of these products are assessed. We know that the debt to income ratio is a strong predictor of financial distress,[4] however not all high-cost credit products currently assess affordability effectively before extending credit to consumers. This again creates a cross-market arbitrage opportunity for less salubrious firms to offer credit to people who are highly likely to end up in financial difficulty as a result. Having successfully dealt with problems in the payday loans market, the FCA must now look at the high-cost credit market more broadly to ensure similar problems elsewhere are tackled too. The success of the FCA's intervention in the HCSTC market, and support from other regulators including the CMA for a more interventionist approach (e.g. some form of price cap in the unauthorised overdraft market) makes us believe this approach is also feasible.

Q2: To what extent is there detriment from high-cost credit products?

Use of high-cost credit by people experiencing mental health problems
In spring 2016 Money and Mental Health surveyed 5,500 people with experience of mental health problems on their financial circumstances. Although our sample was not representative, we believe this to be one of the largest surveys of people with mental health problems ever carried out in the UK. Responses demonstrated that substantial numbers of customers experiencing mental health problems use high-cost credit products: most notably, a greater proportion of respondents had bought goods on credit from catalogues or were overdrawn on their current account than had taken out a bank of building society loan in the past 12 months. Table 1 below summarises the credit products taken out by our sample in the preceding 12 months:

Product	**Proportion of respondents who had taken out this type of credit in last 12 months**
Loan from bank or building society	12%
Payday loan	6%
Credit sale agreement	11%
Mail order catalogue credit	21%
Home credit	4%

[4] John Gathergood & Benedict Guttman-Kenney, "Can we predict which consumer credit users will suffer financial distress?", FCA Occasional Paper 20, 2016.

Storecard	13%
Hire purchase	8%
Overdraft	33%

Source: Money and Mental Health online survey of 5,413 people with mental health problems, March-April 2016.

Evidence of detriment

There is substantial evidence that the use of high-cost credit products is causing detriment to consumers experiencing mental health problems. Analysis of the 2007 Adult Psychiatric Morbidity Survey (a national survey of mental health) shows that 3.6% of people with mental health problems were in arrears on mail-order payments, compared to just 0.7% of people without mental health problems. Similarly people with mental health problems were more than three times as likely (5.1%) to be in arrears of credit card payments compared to those without mental health problems (1.5%), and twice as likely to be in arrears on goods on hire purchase (2.0% compared to 0.7%).[5] Unfortunately the most recent (2014) APMS data has not yet been released, but it is expected to show an increase in the numbers of people experiencing mental health problems encountering financial difficulty as a result of high-cost credit products, as a result of benefits cuts, the reduction in state crisis loan availability, stagnant wages and higher housing costs.

Beyond financial detriment

It is important that the FCA and financial services firms recognise that financial detriment is not the only harm caused by poor lending practices. Regardless of whether an individual is already experiencing a mental health problem, being in arrears on credit payments significantly increases the likelihood of suicidal ideation and of developing a mental health problem. People in problem debt are twice as likely to think about suicide as those not in financial difficulty, even after controlling for other factors,[6] and the more payments a person is behind with, the more likely they are to develop a mental health problem.[7] It is important that this psychological harm is considered and recognised as a justification for tighter regulation across high-cost credit markets.

[5] Jenkins R et al. Debt, income and mental disorder in the general population. Psychological Medicine 2008; 38: 1485-1493.
[6] Meltzer H et al. Personal debt and suicidal ideation. Psychological Medicine 2011; 41, 4; 771-778.
[7] Jenkins R et al. Debt, income and mental disorder in the general population. Psychological Medicine 2008; 38: 1485-1493.

<u>Q3: Where there is detriment, do you consider that it arise from matters not addressed by our rules, or is it mainly caused by firms failing to comply with our rules?</u>

Money and Mental Health have identified three potential causes of the detriment to consumers with mental health problems described above.

1) Insufficient affordability assessments
2) Cognitive and psychological impairments limit consumers' abilities to understand and assess credit agreements
3) Complex and non-transparent pricing

Insufficient affordability assessments
Although CONC requires firms to undertake some assessment of creditworthiness, evidence suggests that at present these regulations are not sufficient to avoid harm to customers using high-cost credit products. While CONC covers affordability in some detail, it appears that either the current regulations do not have sufficient force or are not being implemented effectively to prevent consumer harm. We have specific concerns about secured credit products where credit references are not taken. This reduces the ability of firms to properly assess the affordability of the new loan in context of the customer's other obligations. In addition, Notes of Correction on credit references are, at present, the only tool available to a help consumer with mental health problems, who knows that they can sometimes take out credit when unwell which they later regret, protect themselves from these decisions. Lenders who do not use CRAs will never see these notices, making it essentially impossible for consumers to protect themselves against these forms of lending when unwell.

Cognitive and psychological impairments limit consumers' abilities to understand and assess credit agreements
More than half of respondents (59%) to our spring 2016 survey told us that they have sometimes taken out credit when they were unwell where they would not otherwise have done so when they were acutely unwell; one in ten told us they always take out new loans when unwell. When we asked respondents specifically to consider how their mental health problems had affected their decision making in applications for credit made during the preceding 12 months:

- 24% said they had been unable to understand the terms and conditions.
- 38% said they had been unable to remember what they had been told about the loan.
- 48% said they had been unable to weigh-up the advantages and disadvantages of the loan.
- 34% said had been unable to communicate their decision, ask questions or discuss the loan with the organisation that they applied to.

Worryingly, this data suggests that firms are failing to abide by CONC 2.10 and are providing credit to consumers who may have lacked mental capacity to make the decision to enter into a contract unaided.

It is right that CONC 2.10.4 requires a firm to assume that a customer has mental capacity at the time the decision has to be made, unless the firm knows, is told by a better informed third party, or reasonably suspects, that the consumer lacks capacity. However, the indicators that a customer may be lacking capacity presented under 2.10.8 are not necessarily easy to apply in an online environment. How, for example, would a firm offering a high-cost credit product online gain reason to believe that a customer does not understand what they are applying for, or that they are unable to weigh up the information presented to them? Most online processes simply require customers to tick a box to agree that they understand the information they have been presented with, without any opportunity to ask questions or efforts to check that understanding. We believe that a substantial proportion of the consumer detriment described in our response to Question 3 originates from this lending to consumers who do not properly understand the products they are applying for. This detriment appears to originate in the failure of CONC rules to consider how mental capacity should be determined in online credit applications.

Complex and non-transparent pricing

In hire-purchase or catalogue agreements, pricing of credit is often bundled with the cost of the item, delivery or compulsory insurance which makes it more difficult for consumers to distinguish the price of credit. The cost of overdrafts is similarly bundled with the overall cost of banking, as set out above. These complicated pricing structures are particularly difficult for consumers with any form of cognitive or psychological impairment to navigate; this includes consumers with mental health problems as well as those with dementia, learning disability or acquired brain injury.

With regards to those consumers with mental health problems: we have aggregated research demonstrative that cognitive and psychological symptoms of their illness limit their ability to be an active consumer. People with mental health problems are likely to experience reduced response inhibition, working memory, attention switching and planning and decision making. During periods of poor mental health, consumers' ability to interact with markets effectively is therefore impaired.[8]

Consumers experiencing mental health problems which may make processing complex information difficult, are often therefore at an additional disadvantage in navigating markets for high-cost credit, and may be more likely to experience financial detriment as a result. This form of market detriment is not currently addressed by FCA rules.

[8] Holkar, M. 'Seeing through the fog': How mental health problems affect financial capability. Money and Mental Health Policy Institute. January 2017.

We present suggestions for resolving these sources of detriment in our response to Question 4.

Q4: If there is detriment arising from matters not addressed by our rules, what sort of interventions should we consider? What would be the impact?

Money and Mental Health would recommend that the FCA introduces stricter regulation in the high-cost credit market under the regulator's consumer protection objective.

Robust affordability checks should be introduced across markets. This should include mandatory use of credit referencing agencies to ensure that consumers have the ability to protect themselves from access to credit, including secured credit, using Notices of Correction. We believe the current CONC guidance on affordability checks is insufficient, and stronger guidance is required. Stronger affordability checks for high-cost credit could avoid a substantial proportion of consumer detriment. This may reduce the availability of some forms of high-cost credit, as has been the case in the HCSTC market, but where this credit is made available only for the consumer to ultimately fall into financial difficulty this would prevent some of the worst cases of harm.

The FCA should also consider in the next iteration of CONC how rules under section 2.10 can be effectively implemented online. This is not to suggest that firms should do other than assume that consumers have mental capacity when applying for credit online, but that the regulator and industry should together explore ways of checking consumer understanding and providing opportunities for consumers to receive further support with an application if required.

We also believe that the FCA should expand its understanding of a 'well-functioning market' to consider the extent to which consumers are realistically able to be 'engaged'. We recommend the FCA adopts the principle that where consumer activism or engagement is impaired, both providers and regulators should take active steps to level the playing field, and provide appropriate support to boost their capacity. Support to increase the engagement and activism of consumers who are currently impaired will improve the functioning of the market as a whole.

Q5: Should some of the HCSTC protections be applied more widely? What would be the impact on the cost of or access to credit?

Money and Mental Health believe this question is very finely balanced. We recognise the significant reduction in consumer harm created by the HCSTC protections, but also understand that access to credit is an important consumer right, particularly given low levels of household savings.[9]

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[9] Money Advice Service, Closing the Savings Gap, 2016.

On balance, we believe there may be a case for introducing protections similar to those applied in the HCSTC market, most notably price caps, across the range of high-cost credit products. We reach this decision on the basis that consumers using high-cost credit are, in many instances, unable to engage effectively with the market and as a result experience financial detriment and, in some cases, serious psychological harm.

We believe a price cap is an appropriate mechanism in this market as pressures of time, energy and availability, together with the reduced ability to navigate markets experienced by many consumers as a result of mental health problems, will mean it is always difficult to generate sufficient demand-side engagement to drive effective competition. While the market requires consumers in vulnerable circumstances to evaluate a wide-range of complex products, picking not only from one type of product but potentially comparing different credit options too, it is unlikely to succeed in generating price competition.

However we do not expect this price cap to be a permanent necessity. The introduction of both Open Banking and PSD2 offers significant opportunities for tools to be developed which automate the search and sort process for consumers. We expect these tools will be particularly beneficial for those consumers who, at present, struggle to navigate markets. We hope that they will generate price competition in markets where, to date, demand-side barriers to greater consumer engagement have allowed firms to enjoy excess profits. Price caps can, therefore, be seen as a temporary measure to protect consumers, with the view that in the longer term (we expect within the next five years) technology offers a market opening remedy which removes the source of the market distortion. In the interim, we expect that, as in the HCSTC market, price caps would encourage innovation and lead to the developments of products which, while commercially sustainable, offer a fairer deal for consumers.

Part 2 - Overdrafts

Q7: What do you think are the key issues the FCA should consider on arranged and unarranged overdrafts respectively?

Money and Mental Health's research with consumers with mental health problems suggests that the key issue for consumers in the overdraft market is the unintentional nature of much overdraft use. Many mental health problems are associated with short-term memory impairments, and a substantial number of consumers experiencing mental health problems find themselves using an overdraft simply as a result of forgetting a bill. The charges for this overdraft use can then lead to significant financial detriment. Money and Mental Health hear many ingenious ways in which consumers experiencing mental health problems protect themselves from credit products which they find harmful - from sharing online login details with a family member or friend so they can see credit use, to freezing credit cards in blocks of ice to avoid immediate access. But even the savviest consumer would struggle to exclude themselves from opening an unauthorised overdraft simply by forgetting a payment or mistaking their bank balance. Card transactions up to £10 are usually not authorised in real time, raising the possibility that a consumer can dip into their overdraft, or over a planned overdraft limit, by just a few pounds on a single purchases and incur substantial charges without any warning. Given the memory problems, difficulties processing information and psychological barriers which make it very difficult for some people experiencing mental health problems to engage with their finances, this is not a problem that consumers in this situation can be expected to avoid. Instead regulatory action is needed to allow these consumers to protect themselves from financial detriment associated with unauthorised overdraft use.

The high costs of overdraft use are also a significant cause of concern. The cognitive and psychological effects of mental health problems can make it difficult for consumers to shop around and ensure that the products they use are the best deal on the market for their needs. They are more likely to use default products - and in the case of overdrafts, this means they are highly unlikely to be in a position to engage with competition around overdraft charges.

Q8: What measures could be taken to address these and what would be the risks and benefits?

While we hope the CMA's Open Banking remedy will go some way towards automating current account switching and comparison to alleviate this problem, in the short term we believe a price cap may be required to prevent serious harm to consumers in the absence of adequate demand-side competition.

We also advise the regulator to work with the financial services industry to ensure that those customers who wish to exclude themselves from credit are able to do so. The simplest way to ensure this in the overdraft market may be to ensure that consumers experiencing a mental health problems which affects their financial capability are able to choose a basic bank account which does not offer any credit facility. This could be viewed as a 'reasonable adjustment' under the Equalities Act 2010 given the increased impulsiveness, memory problems and budgeting difficulties experienced by many people with mental health problems.