Regulatory Policy Committee

Rent-to-own price cap (PS19/6)

Financial Conduct Authority

RPC rating: validated

Description of measure

The rent-to-own (RTO) price cap (PS19/6) introduces a total credit cap of 100% on household appliances. It also introduces a requirement that firms must benchmark product base prices (including delivery and installation but excluding any add-on products like warranties etc.) against retail prices. Finally, it aims to prevent firms from increasing their prices for other peripheral goods and services sold with an RTO agreement to recoup lost revenue from the price cap.

Impacts of measure

The measure mainly impacts RTO firms, of which the FCA estimates there to be 20. The regulator estimates total ongoing costs to firms of £29.5m p.a. and total one-off costs to firms of £900k. These costs to business are estimates from:

- loss in net revenue (ongoing costs of £29.2m p.a., £23.6m in the first year). This has been calculated by taking net-revenue, and controlling for returned items. The regulator has done this by using straight-line amortisation over the term of the agreement. The regulator further estimates that gross revenue for the RTO sector would fall by around £32.9m per year;
- further costs from benchmarking (ongoing costs of £310k p.a. and one-off costs of £160k). Benchmarking, the regulator states, would mean that firms would be required to set base prices so they reflect the price of the same or similar goods charged by other retailers. The FCA estimates that RTO firms will need to benchmark between 1,000 and 2,500 products per year. It estimates that businesses would take a maximum of 15 minutes for each product to be benchmarked. The regulator calculates the cost firms would incur by multiplying the time taken by the salary of retail buyers;
- familiarisation and gap analysis (one-off costs of £10k). The regulator has estimated the cost by taking the time it would take businesses to read the policy text, and multiplying this by reading speed and salaries (both for smaller and larger firms);

- IT changes (one-off costs of £260k). The regulator does not expect firms to make large-scale IT changes to comply with the cap. One-off IT costs have been estimated by using research on the structure of IT projects. For the larger firms, these costs will be £56k per firm (spending 156 days of staff time), whilst for smaller firms these will be £5,000 per firm (spending 20 days of IT professional time); and
- governance and change (one-off costs of £340k). The regulator has assumed that larger firms will set up project teams (spending 280 days to deliver the required changes) with larger costs, whilst smaller firms would not devote as much time (6 days). The regulator estimates that the three largest firms would each spend £100k, and that smaller firms would each incur costs of £2,000.

Quality of submission

The FCA presents a clear and concise breakdown of the estimated costs associated with the proposals, and the consultation document (CP18-35), to which the BIT assessment provides a link, contains a thorough and well-evidenced cost-benefit analysis.

The FCA has used consultation actively, which is evident by the fact that they have made changes to the final rules since consulting. These changes ensured that when benchmarking, firms used prices that a reasonably informed consumer would pay. The FCA has also allowed micro-enterprises additional time to comply, which would only marginally impact the overall costs and benefits of the policy. The RPC welcomes this proportionate approach to micro-businesses.

The BIT assessment would, however, be improved by addressing the following points:

Non-wage labour cost uplifts. The regulator appears to have incorrectly used the proportion of labour costs that are non-wage labour costs (30 per cent) as the uplift to ASHE wage costs. The correct uplift is 20.6 per cent (annex A is an RPC guidance note which explains how this figure is calculated). Given the relatively small impact this change would have on the EANDCB (c.£24k), the RPC considers that this is below the proportionate threshold for the RPC to issue an initial review notice. It would also be disproportionate to ask the regulator to change this.

Rationale. The regulator states that "*We found evidence of vulnerable consumers paying high total costs in this market compared to other retailers' prices*." (page 1). The BIT assessment would have benefitted from a more detailed rationale on, for example, how the price cap will benefit these consumers, as it is not clear how much this measure will benefit consumers paying high total costs, nor is it clear how high these costs currently are. The assessment would have benefitted from further detail on rationale, as this would have helped provide a more robust link between the rationale and the EANDCB.

Drafting. The assessment could provide more detail by providing clear cross-referencing to the consultation paper and responses. The BIT assessment provides only a minimum level of detail and requires the reader to revert to two additional documents. To improve clarity, the assessment would benefit from including more information from the two supporting documents or clearly cross-referencing the related sections from CP18/12 and CP18/35.

Discussing Interactions. The FCA should clearly discuss any interactions with wider credit and rent to own market regulations, in order to assess the impacts of interaction between different interventions in the same market.

Although not required in a BIT assessment, the assessment would also benefit from a discussion of how the regulator proposes to enforce the policy, including any related costs to government.

Departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£26.1 million
Business net present value	-£224.9 million

RPC assessment

Classification	Qualifying regulatory provision (IN)
EANDCB – RPC validated[1]	£26.1 million
Business Impact Target (BIT) Score[1]	£130.5 million

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[1] For reporting purposes, the RPC validates EANCB and BIT score figures to the nearest £100,000.

Annex A

Calculating non-wage uplifts

When calculating labour costs, you should normally include non-wage uplifts of 20.6 per cent of the wage. You should consider whether there are any specific circumstances that might warrant a different rate for a specific measure. The details of this calculation are outlined below.

In 2016/17 the Cross-Whitehall Group Regulator Appraisal Group sub-group produced a report called 'Appraisal of guidance'. This was a document aimed at helping regulators to complete their business impact target (BIT) assessments on the impact of guidance changes. A revised version of this report was sent to regulators by BRE on 28 February 2017.

This document included guidance on non-wage labour cost uplifts. Page 6 stated: "*Price consists of a tariff and time. For activities carried out internally, the tariff comprises wage costs and non-wage costs (e.g. national insurance and pensions contributions). For activities carried out by an external provider, the tariff is comprised of the hourly external rate. Time is the amount of time required to complete the activity. The ONS Annual Survey of Hours and Earnings (ASHE) can be used for obtaining median hourly wage rates, and EUROSTAT can be used to estimate non-wage costs (the 2016 uplift factor based on EUROSTAT wage data is 20.2%). For external costs, an estimate of the national average can be used*." The report included a link to the Eurostat page with 2016 data on non-wage labour costs.

As a result of the RPC's scrutiny of regulator BIT assessments covering the period 2017-18, BRE and the RPC felt it would be worthwhile to issue up-to-date guidance and a worked example to assist future regulator BIT assessments.

How to calculate non-wage labour cost uplifts

The link to the 2017 Eurostat figures is: http://ec.europa.eu/eurostat/statistics explained/index.php?title=File:Hourly_labour_costs_in_euro_CORR.png.

The Eurostat table shows non-wage costs to be 17.1 per cent of overall hourly labour costs in the UK.
The calculation of the non-wage labour cost uplift can be explained as follows:

If non-wage costs are a 17.1 per cent of total labour costs, it follows that wage costs are 82.9 per cent total labour costs (1-0.171).

In BIT assessments, regulators (and indeed departments with impact assessments) normally have only wage costs from ASHE. Therefore, to calculate the overall hourly labour cost one needs to add non-wage costs. To do this, multiply the wage cost by (1+ (non-wage cost/wage cost)). For 2017, this is:

wage cost * (1+(0.171/0.829))
or
wage cost * (1+0.206)

i.e. the uplift is 20.6 per cent. In other words, hourly wage costs would be scaled up by this amount (i.e. multiplied by 1.206) to arrive at overall hourly labour costs.

Alternatively, regulators could contact BEIS labour markets who calculate the uplift and could provide it directly. This is illustrated further in Annex 1 below.

When you are determining the cost of labour you should include the wage cost and the non-wage cost as these make up the total labour cost. The wage cost will essentially be the wage per hour or equivalent. The non-wage labour cost includes employers' national insurance and pension contributions.

The RPC recommends that you take the wage cost data from the Annual Survey of Hours and Earnings provided by the Office of National Statistics. There may, of course, be a more relevant data source for your policy which you are welcome to use if you explain where the data comes from and why it is relevant.

The RPC recommends that you take the non-wage cost from the column from the 'Eurostat's statistics table' as standard, and more specifically the UK figure should be included. **The UK figure shows that 17.1% of the total labour cost is non-wage costs**. It does not refer to the percentage of wage costs that are non-wage costs.