Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Dear Sir/Madam,

CMA Retail banking market investigation: further information from the Consumer Panel

The Financial Services Consumer Panel welcomes the opportunity to provide further information by way of follow-up to the Panel's response to the CMA retail banking interim report.

US experiences of opt-in/opt-out for unarranged overdrafts

When the CMA attended a Consumer Panel meeting in December 2015, we offered to provide further information on the US experiences of opt-in/opt-out for unarranged overdrafts.

In the US, banks provide "overdraft programs" alongside their PCAs. Consumers can trigger overdraft program coverage when they attempt to spend or withdraw funds from their checking accounts in an amount exceeding the accounts' available funds. The bank can then choose to either pay or reject the transaction. These decisions, "once made manually at the discretion of each institution's managers, have become largely automated". If the bank chooses to pay the transaction then they can charge the consumer an overdraft fee, if the transaction is rejected then consumers can be charged Non-Sufficient Funds (NSF) fees. Over the past 30 years banks in the US have been moving away from monthly explicit charges and increasing the charges for overdraft programmes.[1]

A 2009 Federal Reserve Board amendment requires account holders to provide "affirmative consent" (opt in) for overdraft coverage of automated teller machine (ATM) and non-recurring point of sale (POS) debit card transactions before banks can charge for paying such transactions.

A data gathering exercise conducted by the Consumer Financial Protection Bureau (CFPB) found that banks implementation of the rules varied. Some did not offer any form of overdraft program, others offered it only for ATM transactions and others for all ATM and POS transactions. Account holders that "chose to opt in to ATM/POS debit card coverage incurred $196 in overdraft or NSF fees on average in 2011, while those who did not opt in experienced $28 in fees on average". Opted-in accounts had higher rates

[1] CFPB, CFPB study of Overdraft Programs, June 2013, page 16

of involuntary closure than accounts that had not opted in at each of the banks included in the CFPB study.

We are not aware of any comparative study undertaken in the UK of the financial impact on consumers of opting-in or opting out of unauthorised overdrafts. The CMA and FCA could conduct a study which should examine the impact on the amount of fees/charges paid and the overall impact on financial wellbeing. It may be the case that accessing very high cost short-term credit through unauthorised overdrafts has a negative impact on overall financial wellbeing.[2]

There are two remedies which the CMA could implement to improve consumers' control over their expenditure and reduce the level of overdraft charges they incur. These would have to be implemented through regulation as the voluntary approach has been shown not to work. These remedies are:

- Consumers should only be provided with an unauthorised overdraft if they have specifically opted-in to the service
- One option could be to allow consumers to opt-in to the service by providing the detail of a linked savings account, from which funds could be taken, rather than go into unauthorised overdraft and incurring charges.

Controls over the level of unauthorised overdraft charges

As we noted in our original response, unauthorised overdraft charges are a form of discontinuous pricing which are used to exploit financial difficulty and small errors from consumers with charges that far exceed marginal cost. Transparency remedies do not have a record of effectiveness in the PCA market and there is little in the CMA report to suggest that transparency remedies will have a significant effect in the future. PCAs are a bundle of services and it might be difficult for consumers to know in advance how they might use their account.

Particularly for unauthorised overdrafts, consumers will find it difficult to understand how they currently use their account, be subject to optimism bias and be unable to use a simple heuristic to find a better account for them. Too often the answer will be "it depends" – it depends on how often, how much and how long they use their overdraft and the transactions they make. This opacity also means that banks do not really compete on unauthorised overdraft charges and there seems little incentive for any new entrants to do so. Indeed, greater switching and competition over the more visible elements of PCAs is likely to encourage banks to increase less visible elements of the offer such as unauthorised overdraft charges.

Introducing some form of cap seems to be the only way to control the level of unauthorised overdraft charges. There are 3 possible structures for the cap:

- Restrict the level of unauthorised overdraft equivalent to that of authorised overdrafts (see examples below of other sectors where contingent charges are restricted)
- Apply the current level of the cap on High Cost Short-Term Credit to unauthorised overdrafts

[2] In the Payday lending market, researchers in the United States found that there was no evidence that "payday loans alleviate economic hardship". Increasing access to payday loans causes difficulty paying rent, mortgage and utility bills – "Counter to the view that improving credit access facilitates important expenditures, the results suggest that for some low-income households the debt service burden imposed by borrowing inhibits their ability to pay important bills." See *Melzer*, The real costs of credit access: Evidence from the Payday Lending market, 2011, http://qje.oxfordjournals.org/content/126/1/517.full.pdf

- Restrict unauthorised overdrafts to the net additional direct administrative costs which firms incur when consumers use their

The direct administrative costs would only include costs which can be uniquely and directly attributable to occasions where consumers use their unauthorised overdraft. This would require further examination by the CMA. Precedent from other sectors (detailed below) would suggest that banks only be allowed to charge costs such as staff, providing information/documents, premises, and IT costs. Where these costs are shared with other activities, banks would only be able to allow for a reasonable proportion of them. Banks would explicitly excluded from charging the cost of bad debts/increased credit risk, uncollected fees, capital costs and executive staff costs. The first stage of implementing this remedy would be for the CMA to examine the costs banks actually incur when consumers use their unauthorised overdraft or have a payment rejected.

Examples of other sectors where contingent charges are restricted to marginal cost are allowed to be included

In other sectors regulators have introduced caps which restrict contingent and default charges to the additional administrative costs which firms incur. Transparency solutions were recognised as being inappropriate or ineffective. These sectors include:

- Mortgages - FCA rules require the charges levied when a consumer is in mortgage arrears to only reflect a "reasonable estimate of the cost of the additional administration required as a result of the customer being in arrears."[3]

  Firms may take into account the following types of cost[4], but must consider the extent to which these are shared with the rest of the business:

  (a) providing information or documents;
  (b) non-executive staff costs;
  (c) premises costs;
  (d) human resources costs; and
  (e) information technology costs.

- Credit Cards - In 2006 the OFT capped credit card default charges at £12 as charges in excess of that would almost certainly exceed the direct administrative costs incurred by the bank.[5]

- Payday Loans - FCA rules cap the amount of interest at 0.8% a day, the default charge at £15 and the total cost at twice the amount of the initial loan. The FCA and CMA concluded that consumers were "particularly insensitive to fees and charges for default or late payment when taking out a loan." The Government's main aim in introducing a cap was to ensure that "payday loans customers do not pay excessive charges for borrowing and to minimise the risks to those borrowers who struggle to repay, to protect them from spiralling costs which make their debt problems worse".

FCA findings from the Cash Savings Market Study

The CMA has rightly found incumbency advantages in the PCA market, and the FCA also found evidence of this in its cash savings market study. In January 2015, the FCA said that the large personal current account providers have considerable advantages in the

[3] MCOB 12.4.1
[4] MCOB 12.4.7
[5] OFT, Calculating fair default charges in credit card contracts: A statement of the OFT's position, 2006

cash savings market because: "they can attract most easy access balances despite offering lower interest rates. The four largest personal current account providers pay on average materially lower interest rates on easy access accounts than other providers. Consumers' desire for convenience of access to their accounts seems to be a significant factor that drives them to use the same provider for their savings account and personal current account. So in order to compete for customers, challenger firms have to offer significantly higher interest rates than are offered by the large personal current account providers."[6] This clearly demonstrates one advantage the larger PCA providers have over challenger banks.

The PCA market, through excessive and opaque charging structures, and complex terms and conditions, has been shown to be unfair to consumers. It demands regulatory intervention on firms to ensure consumers are protected from unfair practices and charges. We reiterate the point made on our original response that it is impossible to gauge whether the current account market is competitive without knowing the true cost and profitability of bank accounts and related products. It is essential that the CMA does further work to carry out this important analysis.

Yours sincerely

Sue Lewis
Chair, Financial Services Consumer Panel

[6] http://www.fca.org.uk/static/documents/market-studies/cash-savings-market-study-final-findings.pdf