HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Martin Wheatley
Chief Executive
Financial Conduct Authority
25 The North Colonnade
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London E14 5HS

4 December 2013

Dear Martin,

CAPPING THE COST OF PAYDAY LOANS

The Government believes that there is a need for a cap on the cost of payday loans; this is why the Government has today laid an amendment to put a duty on the Financial Conduct Authority (FCA) to introduce a cap, to be debated at Lords Third Reading of the Banking Reform Bill next week. I know that you welcome the clarity that a statement of intent from Parliament brings, to confirm that a cost cap is the right way forward and the timetable for implementation. This allows you to focus on designing a cap to meet your new duty to protect consumers from excessive charges when borrowing from payday lenders and ensure better outcomes for consumers. We have discussed the amendment, and the aims and principles you may follow in making rules to implement a cap. This letter reflects those discussions.

Setting the cap is not a job for Government, nor is it right that a cap should be enshrined in primary legislation, given the industry it is intended to bind is so fast-moving and innovative. That is why the cap must be set by the independent and expert regulator, with flexible rule-making powers to ensure that the cap remains effective. But it is right that the Government should give its views as to an appropriate framework of objectives and principles under which you will make rules to implement a cap, and that the Government has an opportunity to give its views on your proposals. Our amendment provides for this.

The fact that the evidence base is still growing, in particular with the Competition Commission's intensive market investigation currently underway, is further reason to avoid taking an overly prescriptive approach to the legislation. The Government knows that you will carefully consider the evidence as you frame the cap, and you are obliged to produce a cost-benefit analysis when you issue your proposals. I welcome the fact that the FCA and the Competition Commission are working together as closely as possible so that you are able to draw on the Competition Commission's valuable analysis. The Government is also committed to ensuring that you can access the information you need to design the cap. The Government will bring forward secondary legislation to allow you to collect information to support your new duty as soon as possible.

We are agreed that an interest rate cap or a cap which only covers some of the fees and charges payday lenders may impose will be ineffective, and the FCA's powers are broad in order to allow you to impose a total cost cap. The Government believes the cap should include all fees and charges which may be incurred in relation to a payday loan, in designing the cap, including default fees and charges and rollover fees. The Government also expects that you will consider the risks of lenders 'gaming' the cap.

The Financial Services and Markets Act 2000 (FSMA) already sets out the objectives that the FCA must advance when making rules: consumer protection, market integrity and competition. The Government's amendment has been drafted specifically to reflect your consumer protection objective. Your competition duty will also apply: you will need to assess the impact of your rules on the ability of the market to meet consumers' needs.

The Government believes that, in terms of consumer outcomes, the main aim of a cap is 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. In short, far fewer payday loans customers should get into problem debt. The Government expects that you will consider this aim as the FCA designs the cost cap.

The Government acknowledges that there are risks in introducing a cap and expects the FCA to balance these in framing your rules. The main risk is that consumers may face reduced access to credit. In designing the cap, it will be important to weigh up the impact on consumers of potential market reactions to the cap. The Government accepts that these risks cannot be eliminated, but finding the right balance will be important. I know this will be uppermost in your mind as you frame the rules.

The Government strongly welcomes the draft rules which you have already published (including your proposals to limit rollovers and prevent misuse of continuous payment authorities). It will be important that other rules and interventions in the high cost short term credit sector work together with your cap proposals to form an effective overall regulatory framework for these lenders.

There are a number of regulatory interventions in the market which may help to create the right conditions to ensure the cap is effective. For example, the

Government shares your concerns that data sharing practices may not be supporting good consumer outcomes in the payday lending market. You are looking into how this could be addressed and I look forward to your conclusions.

This letter sets out our clear roadmap for imposing a cap on the cost of payday loans and securing a better outcome for consumers, and we look forward to Parliament's confirmation of your responsibilities. I look forward to your response to confirm what I have set out in this letter. We have agreed to publish our exchange in order to demonstrate to all interested parties how you will take this important new duty forward.

SAJID JAVID