Rent-to-Own and Alternatives to High Cost Credit Consultation Response

Just Finance Foundation and Church of England Mission and Public Affairs Council

Summary

In January 2019, the Financial Conduct Authority (FCA) launched their consultation on CP18/35: ‘Rent-to-own and alternatives to high-cost credit – feedback on CP18/12 and consultation on a price cap’ consulting on a proposal to place a 100% price cap on the rent-to-own market. This paper presents a joint response to the consultation submitted by Just Finance Foundation and the Church of England’s Mission and Public Affairs Council.

In it, we strongly support the FCA’s proposal to introduce a 100% price cap in the Rent-to-own market, alongside measures to improve lending practices and promote ethical alternatives.

To be effective however, we think that the current proposals need to be strengthened in at least three important ways:

- by including arrears charges within the price cap;
- by strengthening the price benchmarking process, to reduce the risk of the system being ‘gamed’;
- by introducing new requirements on RTO firms to enable customers to make informed decisions about whether to buy providers’ own theft and accidental damage cover.

JUST FINANCE FOUNDATION

Introduction

Just Finance Foundation and the Church of England's Mission and Public Affairs Council value the opportunity to contribute to this consultation on a price cap in the Rent-to-own (RTO) market. In this paper, we strongly support the FCA's proposal to introduce a 100% price cap in the rent-to-own market, but set out our view that to be fully effective, the cap and other proposals in the consultation would need to be strengthened in a number of ways.

About Just Finance Foundation

Established by the Archbishop Canterbury Justin Welby, Just Finance Foundation (JFF) works locally and nationally to increase the supply of fair and affordable finance; to develop fair financial systems in local communities; and to empower low-income consumers by building their financial capability. Through our local networks in the Black Country, Liverpool, London and Tyne to Tweed, we promote and support credit unions and other community finance providers and improve access to free debt advice and appropriate financial services. Cash Smart Credit Savvy, our financial capability programme for adults, is of specific relevance to this consultation. This is an accessible, interactive and empowering financial capability programme, providing an introduction to budgeting skills, saving and spending wisely.

About the Church of England's Mission and Public Affairs Council

The Mission and Public Affairs Council is the body responsible for overseeing research and engagement with social, political and ethical issues on behalf of the Church of England. It was closely involved in the Archbishop of Canterbury's Task Group, set up in 2013, to harness the national and grassroots resources of the Church in support of credit unions and other forms of responsible credit and savings. The Church of England's Parliamentary Unit, which resources the 26 bishops who sit in the House of Lords, also sits under the Mission and Public Affairs Council.

Our responses

Consultation Question 1: Do you agree with our assessment of harm to consumers from high prices?

We endorse the FCA's analysis of the harm to consumers from high prices. Many of the participants in JFF's Cash Smart Credit Savvy courses are reliant on RTO providers to access goods, and what we hear from them is consistent with the consultation report's assessment of the drivers of harm caused by the high and excessive costs paid by RTO consumers.

Low levels of financial literacy and a perceived lack of alternative options are key factors. The people we reach through our financial capability work in local communities don't tend to know where to turn or who to trust for financial advice or information. Typically, they have gaps in their financial knowledge, low confidence when managing money and are unable to secure traditional forms of credit. Support agencies, with whom we work closely at the local level, agree that people at risk of a crisis are hardest to reach due to a lack of trust, shame and illiteracy.

Consultation Question 2: Do you agree with our assessment that other measures will not be fully effective in reducing harm from high prices?

We welcome the actions taken to improve affordability assessments by the FCA thus far, but we agree that the other measures set out in the report, such as limits on consumer borrowing against their net income, will not be fully effective on their own in reducing the harm to consumers.

For the benefits of the proposed price cap to be fully realised, as the consultation paper proposes, it must be implemented alongside measures to promote ethical alternatives. Fair For You (FFY) is an excellent example of such an alternative, through its loan product and service, which is designed to provide low income households with a means of obtaining white goods and other household items responsibly and at reasonable cost. Within the work of Just Finance Foundation, especially through our Cash Smart Credit Savvy programme, we actively signpost individuals to FFY and encourage churches who are part of our network to publicise it. Another example of an excellent ethical alternative, is 'Own Comforts', an initiative which offers Leeds Credit Union members an affordable way to furnish their homes with a pay monthly option offered through access to an affordable loan. Currently it is only operating in Leeds, but has ambitions to expand and become part of a network of partnerships between local credit unions and retail partners.

The benefits of ethical alternatives, such as these, are numerous. In a follow-up survey conducted by FFY customers who had taken out a loan within the last six months, two-thirds of customers reported that they were better able to budget and manage their money as a result of using FFY; half of customers reported that they were feeling less anxious, stressed or depressed; and 45 percent were better able to cope with their physical health problems or disabilities.

We, therefore, welcome the FCA's acknowledgement within the consultation report that alternatives to high-cost credit are vital to ensuring the cap's long-term success, and applaud its continuing efforts to tackle the barriers to availability and awareness. (see Appendix A for our further views on supporting alternatives to high-cost credit.)

Consultation Question 3: Do you agree with our approach to benchmarking base prices?

We welcome and support the requirement on firms to benchmark base prices against mainstream retail prices. However, we think that this requirement is vulnerable to being 'gamed'. Under the proposed rules, it is possible for RTO providers to select their own comparators for each item and effectively set the price of their product at one of the highest prices in the market. It only needs one price outlier in the market in cases where firms can set a price at the highest of three mainstream retailers (or two outliers, where firms must use the median value if one of the three providers is a catalogue credit retailer) to keep base RTO prices at an inflated level, undermining the effectiveness of the price cap.

For this reason, we believe this requirement should be strengthened further and kept under review during the early stages of implementation. A possible option would be to specify a list of national and regional retailers from which RTO providers must select their comparators. In addition, the FCA should consider increasing the number of retailers against which firms need to benchmark their prices, for example from three to five other retailers, and requiring firms to set their price no higher than the median of these prices.

Consultation Question 4: Do you agree with proposals for a total credit cap?

We welcome the FCA's proposal to set a total credit cap of 100% on Rent-to-own goods. High costs are identified as the principle source of harm to RTO customers, contributing to the 'poverty premium', whereby low-income families unjustly pay more for the same goods and services than more affluent families. We think this measure will go a considerable way towards tackling this problem.

As explained elsewhere in this response, we believe that the proposal needs to be further strengthened by including arrears charges within the price cap; strengthening the price benchmarking process; and requiring firms to provide more information to inform customers' decisions about TAD insurance.

Consultation Question 5: Do you agree with our proposals on controlling the price of Theft and Accidental Damage (TAD) cover?

We support the FCA's proposal to control the cost of theft and accidental damage cover, as part of a wider set of measures to prevent RTO providers from shifting costs elsewhere to recoup the revenue lost as a result of the price cap.

However, we do not think that the current proposals go far enough. In particular, we think that new requirements should be introduced on RTO firms to enable consumers to make informed decisions about whether to take out the provider's own TAD cover – including finding out whether they are already covered by their own home contents insurance; and whether the customer would be better off taking out home contents insurance from an external provider, taking into account any differences in the coverage of these policies.

RTO companies currently require customers to have insurance that covers the hire purchase item for theft and accidental damage, and we know that the vast majority of customers (90%) currently buy this from the RTO provider. Given that average cost of home contents insurance is around £60 a year – versus £4 a month per item for accidental damage cover from RTO providers – and, given that two-thirds of RTO customers have more than one active contract, it would often be cheaper for customers to purchase home contents insurance instead.

For example, one woman that JFF has worked with through our Cash Smart Credit Savvy courses was paying for TAD cover on four different RTO items. When we helped her calculate the total cost, we found that the amount she paid over just three months would have been more than enough to cover the annual cost of home contents insurance from an external provider.

We applaud the FCA's recommendations in relation to the sale of extended warranties, particularly the new requirements on firms to provide more information to customers to help them decide whether to purchase these policies. We suggest that it would be sensible and feasible to apply a similar approach to the sale of TAD cover.

Whilst supporting measures to prevent firms increasing insurance premiums or arrears charges without good reason, there is a question as to whether RTO providers are already over-charging for these items in some cases. We suggest that the FCA should consider a more detailed review of all of these charges, once the price cap is in place.

Consultation Question 6: Do you agree with our approach to controlling the price of arrears charges?

Whilst we agree that the FCA should take action to control arrears charges, we think that the best way to take action to control arrears charges would be to include them within the 100% price cap. The failure to do so would undermine its potential to positively impact on lending practices.

Including arrears charges within the cap would give firms additional incentives to carry out a proper affordability assessment, knowing that it may not be able to recover the cost of 'bad' loans through arrears charges without breaching the cap.

Arrears charges are included in the cap on payday loans and we see no reason for not doing the same in the RTO market. One of the impacts of the price cap on payday loans has been an improvement in lending practices, by limiting the risk that lenders can afford to take and reducing the incentive to target people who are likely to struggle with their repayments.

Given that the FCA has stated that firms do not currently obtain a large proportion of their revenues from default charges; given that lower prices should reduce the likelihood of default; and given the evidence that a cap of 90% (rather than 100%) would not significantly impact on the overall viability for firms, we see no good reason why default charges should not be included within the proposed 100% price cap.

If, however, a decision is made not to include arrears charges in the price cap, then we think that there need to be additional protections to limit the frequency, as well as the level, of arrears charges. Even if current practice is to restrict the number of times that arrears charges are imposed on customers, this could change following the introduction of the cap - and there is nothing in the current proposals that would prevent this.

Consultation Question 9: Do you agree with our initial assessments of the impacts of our proposals on the protected groups? Are there any others we should consider?

We agree with the FCA's initial impact assessment and its emphasis upon certain socio-economic groups, such as women, single parents, unemployed people, and those with disabilities. These groups are disproportionately impacted by the harm caused by RTO providers and are, therefore, likely to benefit most from the price cap and other measures to improve lending practices in the RTO market.

Based on our own work in local communities, we would like to highlight two other groups who are particularly reliant on RTO providers:

Firstly, those experiencing in-work poverty - working one or more jobs but dependent upon benefits to supplement inadequate wages. In-work poverty is at a record high and many of the individuals accessing our Cash Smart Credit Savvy programme are in full-time employment.

Secondly, younger people on low to middle incomes are also particularly vulnerable. The Centre for Responsible Credit's 2017 report on the Social Impact of Fair for You highlighted that younger households often have 'thin' credit files and that without enough information for alternative providers, like FFY, to make a positive lending decision, they may have little other option but to go to an RTO provider.

Appendix A: Additional notes on Supporting Alternatives to High-Cost Credit

I. We welcome and strongly support the FCA's proposal (CP18/34 on FCA regulated fees and levies for 2019/2020) to consider exempting community finance organisations and credit unions from paying all FCA consumer credit fees. This would remove a significant administrative burden and barrier to credit unions being able to operate alternative RTO services like the Own Comforts scheme in Leeds.

II. Ethical providers consistently face barriers such as lack of access to capital and a lack of awareness among potential customers, therefore we strongly support FCA's proposal (in paragraph 6.53) to consider the appropriateness of requiring firms to signpost consumers to lower cost credit and other sources of support when rejecting loan applications, since a lack of awareness among potential customers can be one of the greatest challenges for alternatives providers. Indeed, when we tell participants on JFF's Cash Smart Credit Savvy courses about Fair For You, it is often the first time they have heard of them. Increased investment in, and promotion of, FFY and other ethical alternatives would help to address the perceived lack of alternative options.

III. In addition, there are structural barriers to the development of ethical alternatives related to the credit score rating system. More help is needed for 'high risk' groups to access affordable credit – for example, households with 'thin' credit files where there is insufficient information for alternative providers, like FFY and credit unions offering schemes like Own Comforts to make a positive lending decision. Similarly, tenants in social housing tend to struggle to achieve decent credit scores.

IV. Prior to 2013, crisis loans delivered through the Government's Social Fund were a crucial form of interest free credit for families facing an emergency, some of whom were forced to use high-cost credit, including RTO products. The subsequent decline in local welfare assistance schemes (which replaced the Social Fund) and reductions in the real value of other emergency payments, such as Budgeting Loans, have significantly reduced the amount of interest free credit available from the State. Whilst beyond the remit of this consultation, we recommend that Government extend eligibility criteria for Budgeting Loans to cover all low-income families in receipt of Universal Credit. This would help more people to manage a temporary crisis without having to rely on high-cost credit or getting into arrears on their rent and other bills.

References

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