

REVAMP OF THE OVERDRAFTS MARKET- FCA FINAL RULES AND FURTHER CONSULTATION

June 2019

On 7 June 2019 the Financial Conduct Authority (FCA) as part of its High Cost Credit Review introduced changes representing the biggest overhaul to the overdrafts market for a generation. The final rules which are set out in the FCA's policy statement [PS19/16: 'High-Cost Credit Review: Overdraft policy statement'](#) should be considered carefully by banks and building societies in setting their overdrafts prices going forward and in identifying harms arising from repeat use of overdrafts by customers.

INTRODUCTION

In May 2018, the FCA published consultation paper [CP18/13: 'High-cost Credit Review: Overdrafts'](#), in which it discussed the complexity of pricing structures and the high level of fees and charges it sees in the overdrafts market which are harmful and the potential remedies. The FCA further developed its theory of harm and updated its analysis in the following consultation in December 2018 [CP18/42: 'High-Cost Credit Review: Overdrafts consultation paper and policy statement'](#), together with proposed rules to address the harm. The FCA has now published the final rules on overdrafts pricing in PS19/16, which this note discusses while touching upon the requirements on firms to protect customers from repeat overdraft use.

FCA'S POLICY STATEMENT PS19/16

Aligning the prices for arranged and unarranged overdrafts

Firms will need to align the price of unarranged overdrafts with that of arranged overdrafts. The price of using an unarranged overdraft can be lower but cannot be higher than that of using an arranged overdraft. However, firms remain free to set prices so that neither arranged nor unarranged overdrafts become loss-making.

The FCA's analysis revealed that unarranged overdraft charges are causing harm to more vulnerable customers, who are currently paying the most. However, consumers value access to an unarranged overdraft facility and firms are keen to offer the feature to customers (despite its higher risk nature) for quality of service. The FCA further found that firms themselves do not appear to know the differences in costs to provide arranged and unarranged overdrafts, so it does not see a convincing case for allowing firms to charge more for unarranged than for arranged overdrafts.

The FCA's final requirements are set out in a new chapter in the FCA's Consumer Credit Sourcebook (CONC) (Chapter 5C) and are as follows:

- ▶ Firms must make any charges for using an unarranged overdraft the same as (or less than) charges for using an arranged overdraft.
- ▶ For accounts without arranged overdraft facilities, unarranged charges should be no more than charges for an arranged overdraft provided by the same firm on a sufficiently comparable account.
- ▶ If an unarranged overdraft charge is imposed in breach of rules relating to alignment, the obligation to pay the charge will be unenforceable against the customer and, if the customer has paid the charge, they will be entitled to reclaim it.

These requirements come into force on 6 April 2020 and will only apply for charges accruing after the rules come into effect, not those that accrue before the new rules are implemented, but are applied later.

Simplifying pricing and APRs

The FCA has made rules that firms must price overdrafts by reference to an interest rate. Firms will be required to show this interest rate as an Annual Percentage Rate (APR). The FCA believes this model will offer simplicity and clarity to consumers. The single interest rate will ensure that the cost of borrowing is proportionate to the amount borrowed and will enable consumers to more easily work out and compare the cost of borrowing.

The current range of pricing structures in the overdrafts market does not allow consumers to easily compare either different overdraft providers or the cost of an overdraft as against other forms of credit. The FCA is of the view that interest-based overdrafts charging structures (presented with an APR) are more easily comparable and clearer than certain daily pricing structures.

The FCA's final requirements on this are also set out in CONC 5C and are as follows:

- ▶ Firms will be prohibited from charging fixed fees for borrowing through an overdraft (although fees for refusing a payment due to lack of funds ('refused payment fees'), will still be permitted in accordance with the Payment Services Regulations 2017 (PSRs)).
- ▶ Firms must ensure that the price for each overdraft is set as a simple, single annual interest rate – no fixed daily or monthly charges.
- ▶ Firms will be able to provide an interest free 'buffer' or other interest-free amount. But in order to avoid steep increases in cost for small changes in behaviour i.e., where balances go slightly over the buffer, this amount must remain interest free if the customer exceeds it.
- ▶ A single interest rate must be charged on each individual account offered. This could vary for different account types, or even as between different customers holding the same account (allowing for risk-based pricing). However, providers will not be permitted to impose different tiers within a single account or different prices for different types of arranged overdraft within the same account – such as different charges for arranged overdraft and agreed emergency borrowing facilities.
- ▶ The prohibition on charging fixed fees will extend to overdraft facility fees for arranged overdrafts up to £10,000 (however firms would still be permitted to charge an account maintenance fee, whether the overdraft is used or not).

These requirements come into force on 6 April 2020.

Display of APR

A representative APR in certain advertising of arranged overdrafts, as currently required for other forms of consumer credit, should help consumers compare providers and overdrafts with other forms of lending, such as, credit cards.

The FCA considers that APR disclosure is part of an overall package to help consumers compare credit products and providers - and will work together with the use of single interest rate pricing. The FCA has made the rules as were proposed in CP18/42. These are as follows:

- ▶ Firms must disclose, in advertising, the representative APR for their arranged overdraft wherever the requirement to include the representative example is triggered in CONC.
- ▶ If firms use risk-based pricing to charge different interest rates to different customers, the representative APR in advertising should reflect the rate firms reasonably expect a majority of consumers responding to the advert to be offered.
- ▶ Firms must include a representative APR within the representative example required in advertising referring to the cost of the overdraft, as well as in other advertising that triggers the need to include an APR. This includes comparative advertising and promotional offers including incentives to apply for an overdraft.
- ▶ Firms must review their current overdraft financial promotions and amend if necessary to ensure that representative examples are displayed prominently.
- ▶ Firms must position overdrafts as borrowing and to make clear in their financial promotions that the APR allows customers to compare the cost of the overdraft with other providers or with other types of borrowing.
- ▶ Firms should include an 'Overdraft Calculator' in financial promotions on their website.

These requirements come into force on 6 April 2020.

Repeat use

The FCA's analysis indicated a lack of monitoring and early intervention by firms to help those customers with overdrafts who might be in financial difficulties. The FCA is therefore requiring firms to develop a strategy to help these customers. The FCA noted that, while developing their strategies, firms should consider other ongoing work to help consumers with problem debt, such as HM Treasury's proposed 'Breathing Space Scheme'.

The FCA has defined 'repeat use' in the rules as 'a pattern of overdraft use where the frequency and depth of use may result in high cumulative charges that are harmful to the customer or indicate that the customer is experiencing or at risk of financial difficulties'.

The FCA's final requirements on this are set out in CONC 5D and are as follows:

- ▶ Firms must incorporate, within their strategy policies, procedures and systems to monitor customers' overdraft use. However new guidance in CONC 5D.2.3G(3) provides that firms will have discretion to tailor the policies, procedures and systems to their specific business circumstances.
- ▶ Firms must identify repeat users and differentiate and set indicators for those users that show signs of actual or potential financial difficulty.
- ▶ Firms must undertake interventions as set out below:
 - I. For customers with financial difficulties as above, firms must engage with customers and present options for reducing use and explain that, if the issue continues, suspension or removal of the overdraft may occur.
 - II. For all other repeat users, firms must communicate to customers that their pattern of use may be resulting in high costs. Firms must keep this under review and communicate at least annually.
- ▶ Firms must provide the FCA with their strategy and implement their strategy for repeat use when the rules start to apply and provide it to the FCA both at that time and following any substantial changes.
- ▶ Firms must monitor the effectiveness of their strategy and report to the FCA on the outcome of their monitoring after 6 and 12 months, including the current size and number of repeat users and their overdraft balances.

These requirements come into force on 18 December 2019.

Refused payment fees

The FCA is issuing new guidance to help firms comply with existing rules that require that refused payment fees should reasonably correspond to the costs of refusing payments. These may include the costs for providing alerts and notifications including text messages, emails and letters in respect of a refused payment and costs of handling relevant complaints. Costs associated with the general operation of the business, for example the costs of fraud detection and prevention or of provision of bank statements, are not included in the cost calculation.

This guidance will apply to all payment service providers that fall within the scope of the PSRs and has applied since 7 June 2019.

FURTHER CONSULTATION CP19/18

To complement the above final rules, on 7 June 2019 FCA published a further consultation, [CP19/18](#): 'Overdraft Pricing and Competition Remedies' setting out further proposals on overdrafts. Feedback to earlier consultation CP18/42 highlighted that representative APR details may not fully reflect the range of interest rates offered to all customers. To remedy this, the FCA is consulting on proposals to require firms to publish more details of their overdraft charges.

The proposed rules will apply to current account providers that offer overdrafts. The FCA is proposing:

- ▶ To require these firms to publish, in a prescribed format, a range of overdraft pricing details along with their quarterly information on current account services. The pricing information includes the representative APRs they advertise, the level of arranged and unarranged overdraft interest they charge across their live overdraft lending book and the level of refused payment fees they charge;
- ▶ To amend the definition of private bank in the Banking Conduct of Business Sourcebook (BCOBS) 7 and 8 to exclude private banks from the overdraft pricing remedies and ensure the definition of private banks is consistent throughout BCOBS 7 and 8 and CONC 5C and 5D;
- ▶ To exempt foreign currency accounts from requirements to comply with the overdraft competition remedy rules in BCOBS and CONC; and
- ▶ To make minor changes to the rule on alerts auto enrolment.

Feedback on the latest consultation is sought by 7 August 2019. The FCA proposes to publish any amendments to rules in September 2019.

HOW ADDLESHAW GODDARD CAN HELP?

Here at Addleshaw Goddard we have considerable experience in advising firms on their regulatory obligations and requirements. Our market leading Regulated Lending and Banking Group specialises in the areas of Consumer Credit Regulation (Credit Cards and Loans), Bank Accounts, Deposits, Savings, ISAs, First and Second Charge Lending, Asset Finance and Unfair Terms and Unfair Practices. We also have specialist Payments Practice Group who supports clients in many areas including with Payment Services and APIs, Open Banking and E-Money Regulations.

If you would like to know more or would like to discuss anything further, please contact:

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