Chapter 4 Banks and Finance

4.2 Overdrafts

4.2.2 Interest and charges

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DELETE second and third paragraph.

Replace with:

The FCA has recently conducted a review of High-Cost Credit, including overdraft charges, and implemented a series of reforms in this area. In 2016, firms made an estimated £2.3bn in revenues from overdrafts, of which around 30% was from unarranged overdrafts.[1] Further, more than 50% of banks' unarranged overdraft fees came from just 1.5% of customers, demonstrating the harm caused to vulnerable customers in particular from the disproportionate burden of high charges and the repeat use of overdrafts.[2]

In their July 2017 paper, the FCA identified four key factors regarding the potential for harm from unarranged overdrafts:[3]

1. **Unanticipated charges and lack of transparency:** the FCA found that pricing structures are highly complex and consumer awareness of their use of unarranged overdrafts and the charges they may face is low. Without clear and transparent pricing, it is difficult for a consumer to understand the cost of their borrowing, and which borrowing best suits their needs.
2. **High charges:** the FCA found that the charges for consumers who borrow from an unarranged overdraft are high compared to the charges for other high-cost credit. These high prices can cause direct harm to consumers.
3. **Repeated use:** the FCA found that many consumers use unarranged overdrafts repeatedly and that the high charges they face can contribute to their repeat use.
4. **Distribution of charges:** the FCA found that because of the charging structures and patterns of use, unarranged overdraft fees are highly concentrated on a minority of customer who may suffer harm as a result. This means that a small cohort, who may be vulnerable or in financial difficulties may be paying a disproportional amount for the provision of current accounts.

Following these findings, the FCA committed to investigate the issues further and in 2018 and 2019 they published reforms that have changed the way that banks operate and charge for overdrafts. First, in December 2018, the FCA published rules to tackle one of the core drivers of harm they had identified in the overdraft market- low levels of awareness and engagement around overdrafts.

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[1] FCA, *High-Cost Credit Review: Overdrafts* (May 2018) p 3, at https://www.fca.org.uk/publication/consultation/cp18-13.pdf

[2] FCA, *High-Cost Credit Review: Overdrafts consultation paper and policy statement* (Dec 2018) p 3, at https://www.fca.org.uk/publication/consultation/cp18-42.pdf

[3] FCA, *High-cost credit: Including review of the high-cost short-term credit price cap* (July 2017) Chapter 4, at https://www.fca.org.uk/publication/feedback/fs17-02.pdf

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These competition rules, which have been applicable to all firms since December 2019, are summarised in Box 4.1.[4]

<START Box 4.1: Competition Rules

- Firms must provide online, or within a banking app, tools that indicate eligibility for overdrafts.
- Firms must improve the visibility and content of key general information about overdrafts and clearly present overdrafts as a form of debt. This means that firms must provide a calculator so that consumers can check the costs of overdrafts in relation to different patterns of use.
- Firms must automatically enrol their customers into a set of overdraft alerts to address unexpected overdraft use. These alerts, which will normally either be text messages or banking app push notifications, will warn customers of overdraft use that may result in charges.
- Finally, firms must remove any available overdraft from the description of a customer's available funds.

<END>

The FCA hopes that these rules will stimulate competition for current accounts with overdrafts by improving transparency regarding how overdrafts work and what they cost. This in turn will enable consumers to be more engaged and make more informed decisions, and ultimately lead to lower prices and increased service quality. More specifically, the FCA have estimated that 'consumers may save between £59m and £160m in reduced overdraft and refused payment fees and charges, as our alerts will result in them incurring these less frequently.'[5]

In June 2019 the FCA introduced new pricing rules to simplify the pricing of all overdrafts and to end higher prices for unarranged overdrafts. The package of remedies, which came into force on 6 April 2020, is set out in Box 4.2.[6]

<START> Box 4.2 Pricing Rules

- Firms can no longer charge higher prices when customers use an unarranged overdraft rather than an arranged one.
- Most fixed fees for borrowing through an overdraft are banned (fees for refusing a payment for lack of funds are still permitted).
- Simplified overdraft pricing- firms must ensure the price for each overdraft is a simple, single, annual interest rate- no fixed daily or monthly charges.
- Ban on fixed fees extended to include overdraft facility fees for arranged overdrafts up to £10,000.
- Firms must advertise arranged overdraft prices in a standard way, including an Annual Percentage Rate (APR) so that customers can compare products.

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[4] FCA, *High-Cost Credit Review: Overdrafts consultation paper and policy statement* (Dec 2018) p 52, at https://www.fca.org.uk/publication/consultation/cp18-42.pdf

[5] https://www.fca.org.uk/firms/high-cost-credit-consumer-credit/high-cost-credit-review

[6] FCA, *High-cost Credit Review: Overdrafts policy statement* (June 2019) p 3-4, at https://www.fca.org.uk/publication/policy/ps19-16.pdf

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- New guidance issued to reiterate that refused payment fees should reasonably correspond to the costs of refusing payments.
- Firms must do more to identify customers who are showing signs of financial strain or are in financial difficulty, and develop a strategy to reduce repeat use.

<END>

The FCA have commented that these reforms will 'fix the dysfunctional overdraft market.'[7] They will make overdrafts simpler, fairer and easier to manage. In particular, the FCA have estimated that 30% of consumers living in the most deprived neighbourhoods could see an aggregate reduction in overdraft charges of up to £101 million per year.[8]

4.2.3 Regulation of overdrafts

4.2.3.1 Standards of good practice and obligations from the FCA handbook

Page 133-4

DELETE Section 4.2.3.1

REPLACE with:

Beyond the new competition and pricing rules that have been implemented by the FCA in recent years, both the *Standards of Lending Practice*[9] and the Financial Conduct Authority's *Consumer Credit Sourcebook (CONC)*[10] provide standards of good practice and obligations that arise on the part of banks in relation to the provision of overdrafts.

For example, where the customer can overdraw their account without a pre-arranged overdraft, or where they can exceed their pre-arranged overdraft limit, the current account agreement must contain information pertaining to the rate of interest charged, any conditions applicable to that rate, any reference rate on which that rate is based, information on any changes to that rate of interest, and any other charges payable by the customer under the agreement.[11] Where a customer overdraws on their account without a pre-arranged overdraft, or they exceed their pre-arranged

[7] https://www.fca.org.uk/firms/high-cost-credit-consumer-credit/high-cost-credit-review

[8] Ibid.

[9] *Standards of Lending Practice: Personal Customers* (April 2021) at: https://www.lendingstandardsboard.org.uk/wp-content/uploads/2021/04/The-Standards-of-Lending-Practice-for-personal-customers-April-2021.pdf

[10] Financial Conduct Authority, *Consumer Credit Sourcebook (CONC)* at: https://www.handbook.fca.org.uk/handbook/CONC.pdf

[11] Ibid, paragraph 4.7.2. This information has to be provided in writing, at least annually: CONC paragraph 6.3.3.

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overdraft limit for a period of more than one month, and the amount of the overdraft or the excess is significant,[12] the bank must inform the customer in writing of: [13]

- The fact that the account is overdrawn or in excess of the agreed limit,
- The amount of the overdraft or excess
- The rate of interest charged on it
- Any other charges payable by the customer in relation to it (including any penalties and any interest on those charges).

Further, the *Standards of Lending* Practice requires banks to inform their customers of any changes to the interest rates and fees on their overdraft. To help the customer to compare costs, banks must include details of the previous interest rates and fees in the information provided.[14] Firms are also required to ensure that where customers have access to an overdraft, they are supported to limit their use of the product, for instance, by allowing customers to reduce their limits and by having in place timely customer alerts.[15] Finally, banks are encouraged to monitor customers' overdraft limits to ensure they are not exhibiting signs of financial stress and where relevant, offer appropriate information and support.[16]

4.2 Fixed-term loans

4.3.2.3 Default Clauses

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In light of the Covid-19 pandemic, and the resulting significant business downturn, the meaning and effect of MAC clauses has become of critical importance. In particular, it has raised the question of whether the pandemic, and the resulting periods of lockdown, would be sufficient to trigger a MAC clause. While this will ultimately depend on the wording of a particular clause and the context in question, the guiding principles from GHU could be of assistance. For example, in order to be material, GHU tells us that any adverse change must not be temporary, i.e. the change must be durationally significant to trigger a MAC clause. This means that the bank would have to show that any temporary change, such as a temporary lock down, would have a permanent or long-term impact on the borrower's ability to repay the loan. This would not be an easy burden of proof for the bank to discharge. In the recent case of *Travelport Ltd v Wex Inc*[17] the High Court had to consider the

[12] The amount of the overdraft or excess is significant if (a) the account-holder is liable to pay a charge for which he would not otherwise be liable; or (b) the overdraft or excess is likely to have an adverse effect on the customer's ability to receive further credit (including any effect on the information about the customer held by a credit reference agency); or (c) it otherwise appears significant, having regard to all the circumstances. CONC paragraph 6.3.4(3).

[13] CONC paragraph 6.3.4.

[14] *Standards of Lending Practice: Personal Customers* (April 2021) para AM5 at: https://www.lendingstandardsboard.org.uk/wp-content/uploads/2016/07/Standards-of-Lending-Practice-July-16.pdf

[15] Ibid, para AM2.

[16] Ibid, para MM3.

[17] [2020] EWHC 2670 (Comm)

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construction of a MAC clause which the defendant sought to invoke as a result of the impact of the Covid-19 pandemic. The context of this case was not a loan agreement, but rather a business acquisition where the defendant purchaser was given the right to withdraw if there was a MAC in the target company or its assets during the time between exchange and completion of the contract. 'Conditions resulting from pandemics' (the pandemic exclusion) was explicitly excluded as a MAC event in the contract, as were changes in tax, regulatory or political conditions (the changes in law exclusion). However, there was an important proviso which stated that the pandemic exclusion would not be applicable if there was a disproportionate effect on the target companies, as compared to other participants in the industries in which the target companies operated. Following exchange, the global spread of Covid-19 continued and on 4 May 2020 the defendant purchaser notified the seller that they were withdrawing from the acquisition because a MAC had occurred under the terms of the agreement. The seller disputed this and sought specific performance of the buyer's obligations under the contract.

On the issue of whether a MAC had occurred, the court had to consider the 'industry' in which the target companies operated. Mrs Justice Cockerill favoured the defendant's broader definition of 'industries' as meaning the B2B payments industry as a whole, rather than the narrower interpretation offered by the claimant which was the payments industry in the context of the travel sector alone.[18] This meant that the court had to assess whether the target companies had been affected by Covid-19 disproportionately when compared to other businesses in the wider B2B payments industry. As a matter of construction, the court ultimately found in favour of the seller, arguing that the exception to the pandemic exclusion did not apply on the facts. This was because the effects of changes in regulatory or political conditions (including travel bans, closure of businesses and other lockdown restrictions) fell within the changes in law exclusion and it mattered not that they these events also fell within the pandemic exclusion.[19]

4.5 Lender Liability

4.5.3 Insolvency of the borrower

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In this regard, banks are required to follow the *Standards of Lending Practice*[20] for business customers which sets out the best banking practice to follow when a corporate customer is in financial difficulty.[21] Some of these practices are set out in Box 4.8 below.

REPLACE Box 4.8:

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[18] Para 147-166, 210-229.

[19] Para 280-310.

[20] The standards for business customers were revised most recently in August 2020 (and contain temporary provisions relating directly to Covid) and are available at Standards-of-Lending-Practice-for-business-customers-August-2020-Covid-update.pdf (lendingstandardsboard.org.uk)

[21] Similar standards apply in the context of a consumer customer, see, *Standards of Lending Practice: Personal Customers* (April 2021) at https://www.lendingstandardsboard.org.uk/wp-content/uploads/2021/04/The-Standards-of-Lending-Practice-for-personal-customers-April-2021.pdf

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<Start> Box 4.8 Standards of Lending Practice: Financial Difficulty

- The overarching customer outcome is that 'business customers in financial difficulty, or in the early stages of the collections process, will receive appropriate support and fair treatment, in order to help them deal with their debt(s) in the most suitable way.'
- Firms should have triggers and processes in place to help identify customers who may be in financial difficulty and should act promptly and efficiently to address the situation with the customer.
- Firms should have appropriate policies and procedures in place to identify and support vulnerable individuals where this impacts on the customer's ability to pay.
- Customers identified as being in financial difficulty should be contacted and provided with clear information setting out the support available to them, the next steps and where relevant, with any action they are required to take. They should not be subject to harassment or undue pressure when discussing their financial situation.
- Firms should demonstrate an empathetic approach to the customer's situation; listening to and acting upon information provided by the customer with a view to developing an appropriate and mutually acceptable solution.
- If a Firm is aware that a customer is, or suspects that they are, in financial difficulty but is able to uphold their borrowing commitments to the Firm, the customer should be given the opportunity to take action to turnaround the business.
- Firms should guide the customer to appropriate advice which reflects their circumstances and level of borrowing. Where appropriate and available, the customer will be signposted to a third party offering free, impartial debt advice

<End>

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In summary, the independent review identified what it regarded as instances of inappropriate treatment on the part of RBS and GRG in 86% of the 207 cases it reviewed.[22] While RBS has taken some remedial action- in November 2016 they set up a complaints procedure and gave an automatic refund of complex fees[23] paid by SMEs that were customers of GRG in the relevant time period-[24] it was argued that the report would foreshadow some form of lender liability. However, in July 2018, after taking the second phase of the investigation in house, the FCA decided that it would not be

[22] Ibid, p13-14.

[23] Complex fees include: facility fees; excess fees; commitment fees; covenant waiver/breach fees; and security fees.

[24] See https://www.rbs.com/rbs/news/2016/11/GRG.html

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taking any enforcement action against RBS, stating that they lacked the power to take disciplinary action against RBS for their misconduct.[25]

4.6 Security

4.6.1 Proprietary security

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The following point should be added into Box 4.9:

- With effect from December 1 2020, HMRC now ranks ahead of floating charge holders and unsecured creditors with respect to recovering certain pre-insolvency taxes from an insolvent business- known as 'Crown Preference' (Finance Act 2020 s98)

4.7 Innovation in lending

4.7.2 Peer-to-peer (P2P lending)

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DELETE Box 4.11

DELETE Middle paragraph

INSERT

In 2016, the FCA launched a post-implementation review of their regulation of the crowdfunding sector. In July 2018 they reported that there was poor practice among some P2P platforms in relation to a wide range of issues including information disclosure, charging structures, wind-down arrangements and record keeping.[26] As such, the FCA concluded that the regulatory framework needed updating and further rules and guidance were required. These new rules, which were published in June 2019 and came into effect on 9 December 2019,[27] are summarised in Box 4.11.

<Start> Box 4.11 Summary of P2P rules effective from Dec 2019

- More explicit requirements to clarify what governance arrangements, systems and controls platforms need to have in place to support the outcomes they advertise. These new rules

[25] See FCA, *Report on the Financial Conduct Authority's further investigative steps in relation to RBS GR*, (June 2019) at Report on the Financial Conduct Authority's further investigative steps in relation to RBS GRG (fca.org.uk)

[26] FCA, *Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: Feedback on our post-implementation review and proposed changes to the regulatory framework,* (July 2019) at https://www.fca.org.uk/publication/consultation/cp18-20.pdf

[27] FCA, *Loan-based ('peer-to-peer') and investment-based crowdfunding platforms: Feedback to CP18/20 and final rules,* (June 2019) at https://www.fca.org.uk/publication/policy/ps19-14.pdf

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focus particularly on credit risk assessment, risk management and fair valuation practices, especially for platforms with more complex business models.
- Strengthening rules on plans for the wind-down of P2P platforms.
- Application of marketing restrictions to P2P platforms, designed to protect new or less experienced investors.
- Introducing a requirement that an appropriateness assessment (to assess an investor's knowledge and experience of P2P investments) be undertaken, where no advice has been given to the investor.
- Setting out the minimum information that P2P platforms need to provide to investors, with greater transparency around the role of the platform, fees and the arrangements for winding down.

The FCA hope that these new rules will create an environment where investors have clear and accurate information about the platform's services and charges as well as the risks involved, so that they are able to make informed decisions. They also hope that the rules will lead to well-governed platforms that conduct their business in light of the principle of treating customer's fairly, and that have appropriate arrangements to ensure that P2P agreements continue to be administered if the platform ceases to operate for any reason.

Page 186-7

DELETE sentence starting 'The FCA continues to monitor…' and the rest of that paragraph on page 187.

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