MONEY ADVICE TRUST

BUSINESS DEBTLINE NATIONAL DEBTLINE WISER ADVISER

Consultation Response:

FCA call for input: Review of the unsecured credit market

Response by the Money Advice Trust

Date: December 2020

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Introduction

About the Money Advice Trust

The Money Advice Trust is a charity founded in 1991 to help people across the UK tackle their debts and manage their money with confidence.

The Trust's main activities are giving advice, supporting advisers and improving the UK's money and debt environment.

In 2019, our National Debtline and Business Debtline advisers provided help to more than 199,400 people by phone and webchat, with 1.97 million visits to our advice websites.

In addition to these frontline services, our Wiseradviser service provides training to free-to-client advice organisations across the UK and in 2019 we delivered this free training to over 981 organisations.

We use the intelligence and insight gained from these activities to improve the UK's money and debt environment by contributing to policy developments and public debate around these issues.

Find out more at www.moneyadvicetrust.org

Public disclosure

Please note that we consent to public disclosure of this response.

Introductory comment

Nearly all of us will need to access credit at some point in our lives, and many of us will use it regularly to manage our finances and smooth income and expenditure. However, as the Call for Input acknowledges, when the market does not work well for consumers, it can lead to significant harm.

There has been a growing trend over the past decade in lower-income consumers having to use credit to plug holes in their household finances, and to pay ongoing essential expenses such as rent and council tax – and this could become an even bigger driver of credit use given the impact of the coronavirus outbreak on many people's finances. Use of credit to pay for essentials is often unsustainable and can put people at risk of spiralling debt.

Similarly, we see issues where some groups of consumers – often those on lower incomes or in vulnerable circumstances – are excluded from accessing credit that meets their needs, at a fair and affordable price. This can push people towards using harmful high-cost credit, which can cause or exacerbate financial difficulties. Tackling this exclusion is therefore crucial - and we explore in our response how this can be done, whilst also recognising that it raises more fundamental questions around cross-subsidisation, fairness and the role of non-market solutions. This will of course challenge the FCA's existing remit and perimeters so close working with government will be vital.

We welcome the focus of the review on unregulated credit and credit-like products. In our response, we look specifically at employer salary advance schemes, and interest-free buy-now-pay-later schemes, the usage of which has grown significantly in recent years. As we set out in our response, we have concerns that buy-now-pay later products could encourage irresponsible lending, especially as they are increasingly being presented by retailers as the default way to buy online, which means customers aren't always making a deliberate decision to buy on credit. Similarly, on salary advance schemes, we share the FCA's concerns regarding the lack of transparency around the costs and the potential to make repeated withdrawals to make ends meet. There is a strong case for both of these forms of products to come under FCA regulation.

Responses to individual questions

Theme 1 – Drivers and use of credit

Question 1: Please provide evidence and/or views on the current state of the market, as well as key changes and trends, around:

a. who is using unsecured credit, and for what purposes

b. how unsecured credit is marketed by firms, and how it is viewed by consumers

c. the impact of big data and digital technology in this market

We have not carried out our own research on this and therefore do not have access to a full picture of the current state of the market or who is using unsecured credit, beyond our services.

There are clearly shifts in the economic drivers of credit use. The growth in flexible working, due to zero-hours contracts, and the gig economy will have an effect on the need for credit and this might differ from the needs of those in more traditional employment. The growth in self-employment in recent times, from 8% in 1975 to more than 14% in 2019, may generate the need for a different type of financial product as on average the self-employed earn less than employees.[1] The shift from home owners to those who are now in predominately private-rented accommodation, may also have an effect on credit needs. If young people are renting rather than buying, they may have different credit needs. Covid-19 is having an exacerbating impact on the household finances of many of these groups.

[1] https://www.ifs.org.uk/publications/15182

The lack of affordable credit in the UK has been widely discussed. While the credit union sector has grown significantly over the last decade, with 60% growth in membership and 98% increase in loans between 2010 and 2019, the sector remains a relatively small part of the consumer credit sector, with total loans of £1.1 billion at March 2020.[2] This compared to £207.8 billion owed in unsecured consumer debt in August 2020.[3]

The Money Charity monthly statistical report for September 2020[4] states:

- ✓ According to the FCA, in the UK in 2017 there were **1.3 million** people who did not have a bank account. This was **3%** of the UK adult population.
- ✓ According to the 2019 Access to Cash Review, **2.2 million** people use only cash in their daily transactions.
- ✓ According to ONS, **1.11 million** households did not have access to the Internet in Jan-Feb 2020. This included **20%** of one adult households aged 65+.
- ✓ **2 Million** Increase in the number of people with low financial resilience since February 2020. (FCA).

With the shift to digital consumption, many of us might choose online lending and banking services, however a large part of the population are digitally excluded or have no bank account. While technology offers many opportunities to improve lending products and other services for consumers, it can also present risks of further financial exclusion, for example for those who are digitally excluded.

Some people prefer face-to-face contact with their financial services provider, for example because of their mental health or because of a specific disability, while others lack the digital capability to engage with these channels, including due to factors such as insufficient rural broadband access. In addition, there are people, who might be digitally and financially capable, but when it comes to taking a new financial product for the first time, for example a mortgage, might prefer to have a face-to-face conversation.

Furthermore, people in vulnerable situations could be at higher risk of scams and other risky financial situations. For people in vulnerable situations to benefit from technology, application developers should take their particular needs into account when designing new products and processes.

[2] https://www.abcul.coop/credit-unions/credit-unions-facts-and-statistics
[3] https://themoneycharity.org.uk/media/October-2020-Money-Statistics.pdf?utm_source=Individuals+-+The+Money+Charity&utm_campaign=c9e831a96a-The+Money+Statistics+February+2020_COPY_01&utm_medium=email&utm_term=0_1e74a1b033-c9e831a96a-1204724073
[4] https://themoneycharity.org.uk/media/September-2020-Money-Statistics.pdf

However, there is a growing group of lower-income consumers who are potentially using credit to plug holes in their household finances, and to pay ongoing expenses such as rent and council tax. According to the Money and Pensions Service, nine million people say they often use credit cards and payday loans to meet essential food and energy bills.[5] This group is reacting to pressure on their household finances, and access to high cost credit is not necessarily a useful tool to deal with these pressures.

Question 2: What are the main trends and challenges created by these changes?

The FCA needs to consider if the regulatory framework is sufficient for the challenges and future developments in the unsecured lending market.

- ✓ The regulatory perimeter needs to be looked at again. Many people would reasonably expect that financial products with the same lender will all be regulated by the FCA when they may not be. All financial products need to come under the regulatory umbrella. The perimeter causes confusion and allows for scams to proliferate and firms to develop unfair but unregulated products whilst themselves being authorised by the FCA. This may need new legislation to be put in place to achieve this aim.

- ✓ When the consumer credit regime passed to the FCA in 2014, the decision was made that consumer credit would not fall under the Financial Services Compensation Scheme. This has resulted in a failure to protect or compensate consumers who have taken out financial products, particularly with payday lenders, who have then subsequently failed. These are often the most financially vulnerable groups in society, who are not eligible for any compensation beyond a few pence in the £ once the administrators for the firm have done their work. One option would be to encompass consumer credit within the Financial Services Compensation Scheme.

- ✓ The FCA needs to be more agile in the way in which it identifies a poorly designed financial product, major problems with affordability assessments or a lender that is not treating customers fairly. As an example, the free debt advice sector has repeatedly raised the issues we came across relating to certain high cost credit products such as guarantor lending, but this was not prioritised by the FCA at the time. We now see an extraordinarily high number of cases being upheld at the Financial Ombudsman Service[6] and an investigation into such lending by the FCA.[7] We fear that this could be another sector that is unable to fulfil its compensation obligations to its customers and the most vulnerable will lose out.

[5] https://www.theguardian.com/money/2020/jan/21/ministers-launch-financial-wellbeing-scheme-to-help-savers
[6] https://www.thetimes.co.uk/article/ombudsman-upholds-nine-in-ten-complaints-on-guarantor-loans-wcfw7ggvp
[7] https://www.thisismoney.co.uk/money/cardsloans/article-8377251/FCA-launches-investigation-guarantor-lender-Amigo-Loans.html

- ✓ The FCA could consider a 'deeper' regulatory approach as part of this review. This could involve strengthening consumer protection by mandating or prohibiting certain features to encourage fair design and good consumer outcomes. New products would need to meet set standards on affordability assessments, product information, vulnerability, sustainability and fair outcomes for consumers. A universal design standard could be adopted to ensure these product rules are met. The FCA rightly has to balance regulating markets with the need to encourage innovation, however this review could be an opportunity to review the balance between these two outcomes.

- ✓ As we explore further in response to question 9, we welcome the FCA's direction that firms should consider using an inclusive design approach. However, we would also like to see the FCA utilising this within their own work, to ensure they are taking an inclusive approach to developing regulation. A regulatory framework which puts inclusive design at its heart is likely to transform outcomes for consumers – particularly those on the lowest incomes and result in a better-functioning, more effective market with much less potential to cause harm.

Question 3: What are the likely dynamic changes you expect in the market, and what might the biggest effect of these be?

We are not in a position to answer this question.

Question 4: What do you see as the main drivers of demand for credit? How do they affect consumer demand for credit, now and in the future?

We would expect the drivers of demand for credit to be fairly standard over time. The need to fund the purchase of household goods, holidays and to cover unexpected purchases and emergencies are fairly unlikely to change.

However, there is a growing group of lower-income consumers who are potentially using credit to plug holes in their household finances, and to pay ongoing expenses such as rent and council tax. According to the Money and Pensions Service, nine million people say they often use credit cards and payday loans to meet essential food and energy bills.[8] This group is reacting to pressure on their household finances, and access to high cost credit is not necessarily a useful tool to deal with these pressures.

[8] https://www.theguardian.com/money/2020/jan/21/ministers-launch-financial-wellbeing-scheme-to-help-savers

It is possible to argue that demand for credit can be fuelled by the products available and how accessible they are. It has been suggested that the high-cost short-term credit market created its own demand and own set of customers. The ability to obtain instant access to online credit could become a habit rather than demonstrate a latent demand for such a product.

We would counsel caution in relation to the growth of interest-free buy now pay later products online. We have concerns that these short term buy-now-pay later products could encourage irresponsible lending. They are increasingly being presented by retailers as the default way to buy online, which means customers aren't always making a deliberate decision to buy on credit. And in some cases people are unaware they have even taken out this credit.

Question 5: Which consumer groups currently struggle to access the credit market, and why? How has this changed over time and how do you expect it to evolve?

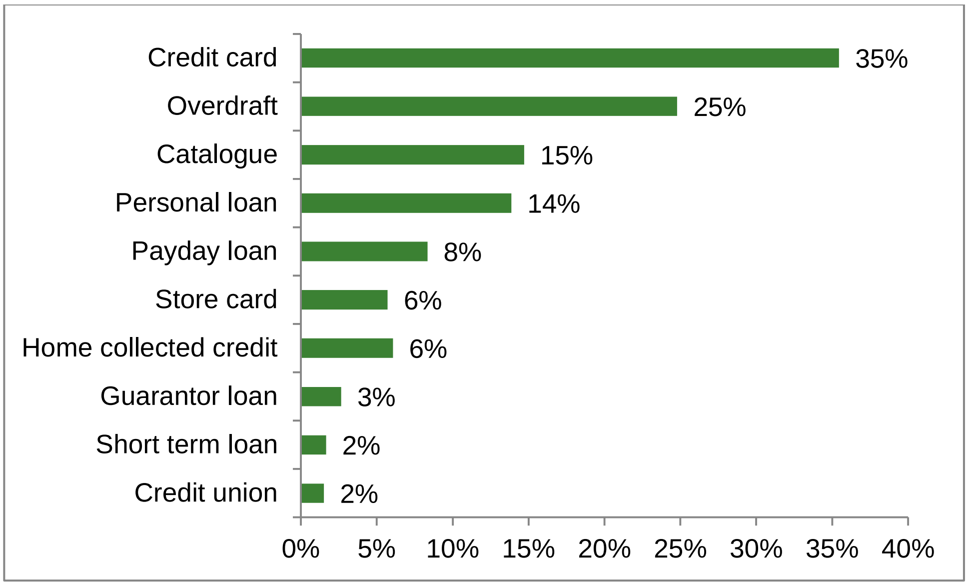
We have regularly stated our view in FCA consultations that it is not reasonable to expect consumers – particularly those in vulnerable circumstances who may be in debt or who have suffered detriment when taking out financial products and services – to be able to act rationally as "perfectly informed" consumers. This must be taken into account in designing regulation, and by firms as they design financial products and services.

People in debt

We would expect that consumer groups who struggle to access the credit market will include most of our National Debtline and Business Debtline clients. Once someone is struggling to pay their credit commitments and falls behind with consumer credit payments, this will be marked on their credit file and affect their ability to get any credit at all. In a typical scenario, this is often preceded by a debt spiral where people try to keep paying their bills by taking out further credit, often of an increasingly sub-prime nature. This is likely to result in the end of the road in taking out additional credit as payments are defaulted.

The chart below shows the typical range of types of unsecured credit that a client of National Debtline held when they contacted us for advice (note: this data is from 2019 and so before the impact of Covid-19).

National Debtline unsecured credit debts 2019



This large group of consumers who can no longer access mainstream credit, will still have a need for further borrowing where there is an emergency such as a broken washing machine, or a new school uniform to be purchased. There is clearly a dilemma here, as this group can no longer access cheaper forms of credit, but neither can they afford to pay back high-cost credit in any form.

This is often due to living on an income that is too low for their basic needs, due to factors such as low wages, the impact of welfare reform, and the rise in the cost of living. We found in our client surveys, that in 2018, 48% of people contacting National Debtline had essential outgoings that exceeded their income, (a deficit budget), a significant rise compared to 27% in 2009. In many cases this means people cannot cover their basic rent and council tax or other household bills, let alone consumer credit payments.

The argument from higher-cost lenders is often that they are giving access to others that wouldn't get mainstream credit. However, for this group of consumers, further high-cost credit will only make their situation worse, and does not help. We believe that part of the solution is not to lend to people at high-cost or through products that are risky or unsuitable for their needs.

Credit scoring

Other groups who may struggle to access the credit market will be those who have a thin credit record, perhaps due to age, lack of a fixed address, immigration status, or not having taken out many credit products. Credit scoring and the lending decisions that are made based on this information appear to have the effect of excluding those who may be perfectly able to repay credit but their files do not demonstrate that this is the case. We are not convinced, for example, that a high interest introductory credit card product is the answer to developing peoples' creditworthiness for future credit products.

Credit decisions

Those who are better off financially can access cheaper credit than those who will struggle to pay. This seems fundamentally unfair. Quick lending decisions made digitally can exclude people who are credit worthy but do not fit the broad criteria. This can lead to people turning to higher risk products as a result which they cannot afford. Lending risk assessments may easily exclude people if they are narrowly targeted at certain groups of consumers only. Innovation in digital platforms can enable targeting of loans towards certain groups.

We are concerned that expensive credit is very easy to access digitally. It appears that high cost credit providers can rely on an ever-present demand for credit by people who are in difficult circumstances when pricing products rather than competing on service, and interest rates and affordability. When we look at people in multiple debt, they will often have a cluster of similar products such as HCSTC, catalogues and home-collected credit.

There is clearly a dilemma between putting in place more stringent requirements on lending small amounts to higher-risk groups, and protecting people who should not have access to this credit because they cannot afford to pay it back. We worry that the unintended consequences are that more people are refused credit or are pushed into using more high-cost forms of credit. There needs to be an adequate safety net for people who cannot afford to take out credit and are ineligible to do so under the creditworthiness rules.

Question 6: Do you agree that in a healthy credit market, there will be people who will not be able to access credit? What are the characteristics of these people and what would the impact of not having access be on them?

It is complicated to balance the needs of consumers and financial inclusion measures with costs for lenders. In our experience, there are many people accessing high cost credit when this is harmful to their finances. If people are using credit to pay their household bills or when they are behind on their household bills, this is not a long-term solution. In many cases people need support through debt advice services rather than accessing further credit.

We would agree that there are people who are unable to afford to pay high cost credit, and are unable to afford to pay back any type of credit which attracts interest. People in this situation may be on very low or benefit level incomes. They may be in severe debt problems, like many of our clients. They may have deficit budgets which make it impossible to make ends meet.

As we have said, this group will still have unexpected items of expenditure that they cannot budget for, and emergencies to deal with. There need to be alternatives in place for people who cannot afford to pay back any form of credit, even at low interest rates.

We would like to see further analysis of the size of this group, and what their financial needs are to inform government policy about the right solutions. However, some of this work has already been carried out by research into no interest loan schemes. It is vital that the proposed no income loans scheme is put in place as soon as possible to provide no-interest loans to low-income households. This model has been demonstrated to work very well for people on low incomes who need to access household goods and other financial services but are at risk of taking out high cost credit or missing household bills.

We would suggest that the impact of localised welfare assistance schemes should also be considered. The DWP abolished community care grants as part of the national Social Fund in 2013, which means there is little access to grants for household goods or expenses. In England, this has been replaced by local authority schemes but the support is both patchy and uneven. For people who cannot access credit or afford to pay back even low interest credit, this can mean there is little support, unless they can access a charitable or trust fund payment.

We would also highlight the Centre for Responsible Credit Rent-flex project[9] which is in an expanded pilot phase enabling social housing tenants to plan when to pay their rent over the year, to allow flexibility for expenses such as Christmas and the cost of school uniforms, without resorting to expensive credit. Flexibility on payment of household bills could help to mitigate the potential of households falling into a debt spiral, smoothing planned expenditure over the year.

We appreciate that the FCA is well aware of the risk of more people falling through the cracks without having recourse to adequate alternatives e.g. for the purchase of essential household goods. Credit unions and other not-for profit lenders are equally bound by affordability rules and are unable to provide credit to those who cannot afford to pay. An urgent policy solution is required.

Theme 2 – Change and innovation in the supply of credit

We have not responded to question 7.

[9] https://www.rent-flex.com/

Question 8: Regarding unregulated credit or credit-like products:

a. What evidence can you provide of the increase in availability and uptake of these products?
b. What impact has this had on the regulated credit market, and how might it play out in the future?
c. What are the characteristics of customers of these products?
d. What role do these products play in the wider economy?
e. What benefits, risks and harms do these products create? Is there more the FCA or other authorities could do to preserve benefits or address harms and risks?

We have limited our comments to the potential benefits, risks and harms of employer salary advance schemes, and interest-free buy-now-pay-later schemes.

Employer Salary Advance Schemes

We are concerned about the lack of regulation in this sector. We would support salary advance products becoming regulated under the FCA regime. We share the FCA's concerns regarding the lack of transparency around the costs of these schemes and the potential to make repeated withdrawals to make ends meet.[10] Salary advance schemes have the potential to trap people into debt, where people have to borrow earlier in the following month due to last months' salary having been reduced to repay previous loans.

We appreciate that there may well be some advantages to the schemes which charge a flat fee, or a percentage per wage advance which are much cheaper than forms of HCSTC. It is important however, that employees understand how these loans are structured, and the true costs of taking out the loans on a repeated basis. There is also a risk that having access to a preferential form of repayment by automatic deductions from salary, means that what is in effect an unsecured loan takes precedence over other household expenses that month.

[10] https://www.fca.org.uk/news/statements/fca-sets-out-views-employer-salary-advance-schemes

Salary advance schemes should be subject to the same regulatory regime as other forms of credit. They should be subject to suitable affordability rules, and advertising rules. It is also not clear how these schemes affect credit ratings and whether they are, or should be, recorded on credit reference files.

Buy-now-pay-later

We have all seen the growth in unregulated credit agreements that are short term buy-now-pay- later products. These are promoted by a number of specialist lenders in partnership with retailers, often involving the sale of clothing and fashion accessories. There is no interest or fees added.

We are concerned that this product could encourage irresponsible lending. The new services are increasingly presented as the default way to buy online. The option to buy is usually prominent when the consumer reaches the checkout. This makes customers less likely to make a deliberate decision to buy on credit. And in some cases people are unaware they have even taken out this credit. There is no proper credit check carried out or affordability assessment made to see that the consumer can afford to pay the money back.

Companies offering ‘buy now pay later’ schemes should assess whether customers can afford to repay in the first place and be as clear as possible in their terms.

Retailers should not present these payment services as the default way to pay online.

We are concerned that people will be persuaded by advertising to obtain desirable items that they can buy immediately even if they can’t afford it. The target tends to be younger people who may not have much experience of managing credit. Young people who may not have considered taking out traditional forms of credit to make these purchases are being given this new payment option, but this is not risk free. This may lead into a spiral of debt, when people take out further lending or use their overdraft to pay the debt off.

It is also not clear how credit ratings are affected for non-payment, with different firms taking a different approach depending upon the product. Services need to be clearer about the effect that missed payments on some of their products may have on the consumer.

Consumers do not expect their debts to be passed to collection agencies if they have missed a payment deadline. This should be made much clearer to consumers.

We think these new types of credit products should come under FCA authorisation and be regulated under the Consumer Credit Act 1974.

Question 9: Please provide evidence and/or views on:

a. where the gaps are in the supply of unsecured credit, and where they are likely to be in the future

b. the effect on consumers of any gaps in supply

c. the main barriers to a sustainable market developing to fill these gaps

d. what role the FCA, or others, could play in helping innovation and growth in these areas

The credit market does not currently work well for all consumers who need to use it. Not everyone is able to access suitable credit products, that meet their needs and which are genuinely affordable for them. Many people, particularly those on low incomes or with poor or thin credit files, are excluded from mainstream credit. The FCA's Financial Lives survey found that 12% of UK adults using credit had been turned down for credit in the last 12 months.[11] People considered to be vulnerable were almost four times more likely to say they had been rejected for credit in the previous year - 19% of those with a vulnerability had been turned down, compared to 5% of those without[12] - highlighting how the gaps in the credit market can disproportionately fall on those who are already facing disadvantage.

While there has been welcome focus in recent years on expanding affordable sources of credit, and an expansion of this type of lending, this remains a relatively small section of the market and gaps still exist. The rules relating to credit union common bonds, low awareness and individual lenders risk appetite can all constrain who credit unions can lend to. According to research, an estimated 180,000 credit union members were turned down for a loan in 2017 (most recent figures available).[13]

Data for those turned down from CDFIs is not publicly available, but there remain significant gaps here too. The CDFI sector is still relatively small and, again, awareness is an issue, as too is sustainable funding for the sector. Unlike credit unions, interest rates are not capped so there are many people for whom CDFI loans would not be affordable.

[11] FCA (2017) Financial Lives Survey, Consumer Credit Data Tables, Table 3.
[12] Ibid
[13] Financial Inclusion Centre (2018) *An insight into Credit Union membership,* Available here.

It is also worth reflecting here on the gaps in the social security safety net of grants and no-interest loans. As mentioned in question 6, the abolition in 2013 of Community Care Grants and the devolution of welfare assistance schemes to local authorities (without ring-fenced funding) has seen a significant contraction in access to grants and no-interest loans for household goods or expenses. Similarly, changes under Universal Credit have restricted eligibility for no-interest loans through benefits. Under the Universal Credit 'Budgeting Advances' system, only those people who are unemployed, off work ill, or earning less than £2,600 over 6 months are eligible. This creates a particular gap for people who are in employment, but which may be insecure or low paid, and who therefore struggle to access mainstream credit but no longer have recourse to help through the benefits system to meet the cost of large expenses.

For people who cannot access credit or afford to pay back even low interest credit, this can mean there is little support, unless they can access a charitable or trust fund payment, which are themselves seeing increasing demand.

Effect of exclusion on consumers

Being unable to access suitable credit products has a significant impact on people. It pushes people to use high-cost, more risky credit. This places people, usually already on low incomes, under even greater financial pressure as they have to pay more to access credit than other consumers. If repayments cannot be made, it places people at significant risk of spiralling debt. There is a vicious cycle here: people on lower incomes and with tighter budgets have to use more expensive credit that then puts even more pressure on their budget and leaves less money for essentials – driving the need for credit again. Furthermore, if people fall into debt due to being unable to keep up with repayments, this is likely to impact on their credit score and lead to further exclusion from the market.

All of this can have a real impact on people’s health and wellbeing. Almost three quarters (74%) of National Debtline clients surveyed, who had a payday or short-term loan said the actions of the lender had a negative impact on their wellbeing.[14] The FCA’s own work on the high-cost credit review also identified significant harm – both financial and non-financial – that can be caused by high-cost credit products.

The other result of exclusion from access to suitable credit products is that people have to go without essential goods. Nearly all of us will need, throughout our lives, the ability to spread the cost of larger, essential purchases – for example, when the fridge or over break and need replacing, or the washing machine goes and there is no way to wash your children’s school uniform.

[14] National Debtline annual impact survey 2020; Base – those who had a debt with a payday or short term lender (77)

The need to spread large expenditure is particularly important for those who have low or no savings (typically those on lower incomes) – the very same group who are likely to be excluded from the credit market too. When people are unable to access appropriate and affordable credit to make these purchases, the result is often that they have to go without. Indeed, the FCA's Financial Lives work found this to be a common outcome after being rejected for credit. Of those who had been turned down for credit, or who did not apply in expectation they would be rejected, in the last 12 months, 61% said they went without.[15]

The charity Turn2Us found that over two million households – 4.8 million people – are living without at least one essential household appliance, including 1.9 million people living without a cooker, 900,000 people without a fridge and 1.9 million people without a washing machine.[16] Living without these appliances not only has a physical and emotional impact, but a financial one too: Turn2Us estimate that living without a cooker, and relying on microwave meals, is twice as expensive as making home cooked meals – adding £2,100 a year to a family of four's food bill.[17]

Barriers to a sustainable market developing to fill these gaps

In recent years, significant work has been undertaken – not least by Fair 4 All Finance - to assess the current state of the affordable credit market, understand the barriers to growth and work to address these. While credit unions are a key part of the response to this issue, as we mentioned above, there are a number of factors, which mean they cannot fill the gaps in the market entirely. This includes the rules relating to credit union common bonds, individual lenders risk appetite, and the save to borrow model, as well as wider issues around awareness. Across the affordable credit sector as a whole, sustainable finance / funding remains a key barrier to growth.

More broadly, we would suggest that a key driver in why the market has not responded to fill these gaps is that the question around access to credit is more broadly a social policy question. Those who are excluded may be 'riskier' or cost more to serve (although we would also highlight that people can be excluded from a market for a whole host of reasons, not just due to low income). This means that addressing these issues requires us to consider more fundamental questions around fairness and cross-subsidisation that a purely competitive market will not necessarily respond to without further intervention.

This challenge is not completely unique to the credit market. Other essential services – such as water and energy have had to deal with similar issues, although all three markets are arguably at different stages of responding to this. The water sector has social tariffs in place to help those on lower incomes as well as the WaterSure scheme, which helps those with certain vulnerabilities who therefore have a higher than normal usage – the cost of which might otherwise be unaffordable or a barrier to access. In energy, we have seen some interventions in terms of price caps and sector-wide schemes like the Warm Home Discount.

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[15] FCA (2017) Financial Lives Survey, Consumer Credit Data Tables, Table 8.
[16] Turn2Us (2020) *Living without: The scale and impact of appliance poverty*
[17] Ibid

However, the consensus on whether credit is an ‘essential service’ is perhaps less developed than in the energy and water sectors, and therefore the question of how to ensure access for all, at a fair price – and what market intervention might be required to achieve this - has had less attention to date.

Role of the FCA

Considering the question of access in this context has implications for the FCA’s – and other’s roles – in addressing exclusion and expanding the provision of affordable forms of credit. We warmly welcome the action the FCA has taken to date to support and promote the importance of expanding access to affordable credit through credit unions and CDFIs – and we hope this will continue.

The FCA also has a vital role in ensuring that any innovation within the credit market works in the interest of consumers. With innovation and new technology, there is always a risk that, instead of promoting inclusion, it entrenches existing disadvantage, exclusion and inequality. As a regulator with a clear consumer protection objective, the FCA need to be proactive in adapting regulation to deal with new products, services and business model, as well as ensuring that firms are taking into account the needs of vulnerable consumers when they are designing products and services, and that these will not cause harm or further exclusion.

However, this action is not enough on its own. In our opinion, credit – or at the very least the ability to spread expenditure and the cost of purchases – is an essential service and we think there needs to be a new and concerted focus on ensuring that everyone who needs this can access it at a fair and affordable price. As set out above, this does raise fundamental questions around cross-subsidisation, fairness and the role of non-market solutions. This will of course challenge the FCA’s existing remit and perimeters so close working with the Government will be essential.

One area in which rapid progress could be made is through the piloting of a No-Interest Loan Scheme. With Fair4All finance aiming to take this forward, the FCA can play a key role not only in supporting the pilot but also in encouraging firms to think about how they can contribute to it. The success of a similar scheme in Australia can in pat be attributed to the public – private partnership at the heart of the scheme; with the National Australia Bank providing the capital, government funding the operational costs and charities delivering the scheme on the ground.

In tackling exclusion from the credit market, one thing that will be vital is to involve those with lived experience of the problem in identifying and developing solutions. In the FCA’s draft vulnerability Guidance, there was a welcome direction that firms should consider taking an *‘inclusive design approach to meet the needs of their vulnerable customers as well as the majority of consumers in their target market’*.

We strongly support the use of inclusive design to improve markets, products and services and in January 2021 will be releasing two new reports as part of our joint programme with Fair By Design: *Inclusive Design in Essential Services*. This will include a practical guide for firms, but also a guide for regulators looking at how they can use inclusive design to tackle market issues and improve outcomes for consumers. We would suggest that access to credit is a key issue on which taking an inclusive design approach could lead to significant benefits.

By directly involving people with experience of exclusion from the market, or who have had to use high-cost or unsuitable credit products, the FCA, firms and government will be able to get a much richer and accurate understanding of the problem and increase the chances that any solutions will actually be effective. Such an approach can also help challenge to previous understandings of, or seemingly intelligent assumptions about, problems and solutions that can be barriers to effective solutions developing. The guide for regulators that we are releasing with Fair By Design in January will set out further detail on how regulators can use inclusive design approaches, including practical tools, and we would be happy to discuss this further in the context of the credit market review.

Theme 3 – The role of regulation in unsecured credit markets

We have not responded to theme 3.

Theme 4 – The impact of Covid-19 and the FCA's response

Question 15: Please provide evidence and/or views on the impact of Covid-19, both now and as you expect it may play out in the future, on:

a. the demand for different types of unsecured credit

b. the supply of credit, including impacts on sustainability of affordable lending and gaps in provision

The scale and impact of covid-related income shocks has been well documented in recent months – with the FCA's own research estimating that around a third of adults (31%) have seen a decrease in income, with households seeing income fall by a quarter, on average.[18] Among National Debtline clients surveyed in May - early on in the pandemic - almost half had experience a drop in income caused by Covid-19.[19]

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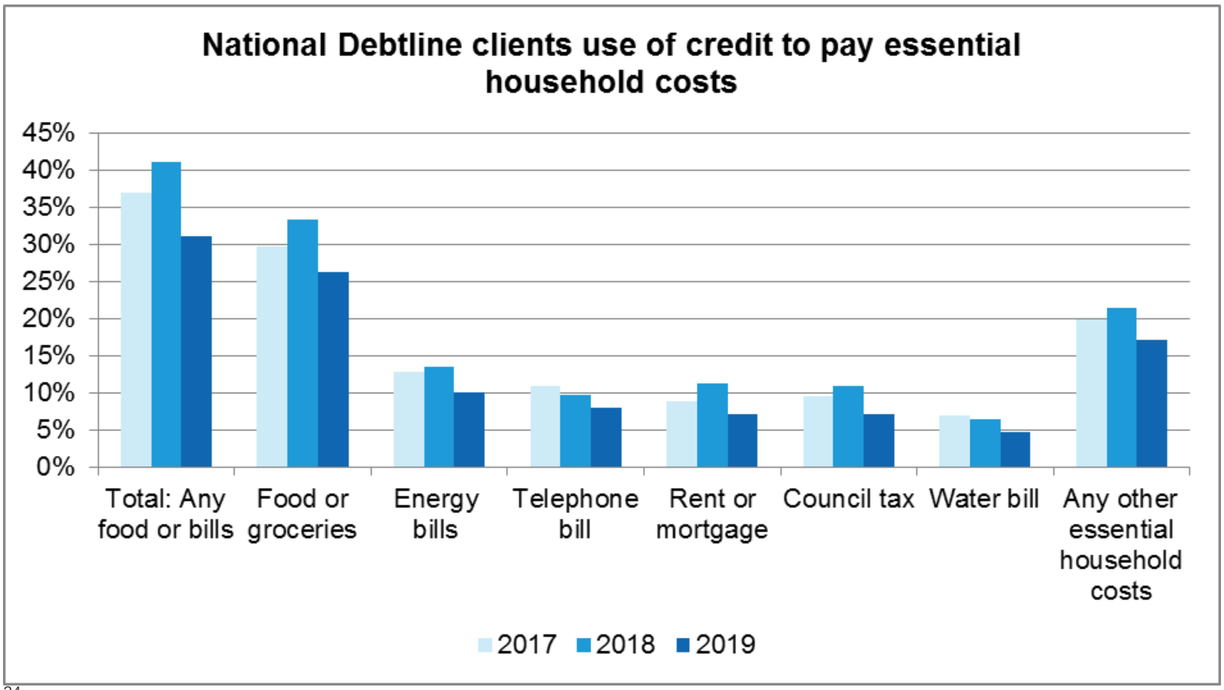
[18] https://www.fca.org.uk/news/press-releases/fca-highlights-continued-support-consumers-struggling-payments

[19] Survey of 370 National Debtline clients, conducted online in May 2020. For more information see: At the sharp end: A spotlight briefing on the impact of Covid-19 on National Debtline clients

The figures were even higher for our self-employed clients on Business Debtline. 93% experienced a drop in income, and a third said they had experienced a 100% drop in income as their ability to run their business or trade was curtailed overnight.[20] While government support schemes have been welcome, not everyone has been able to access them and even those who have remain on a reduced income – such as 80% of their wages. As the outbreak lasts for longer, more and more people are likely to struggle with living on a reduced income for a prolonged period.

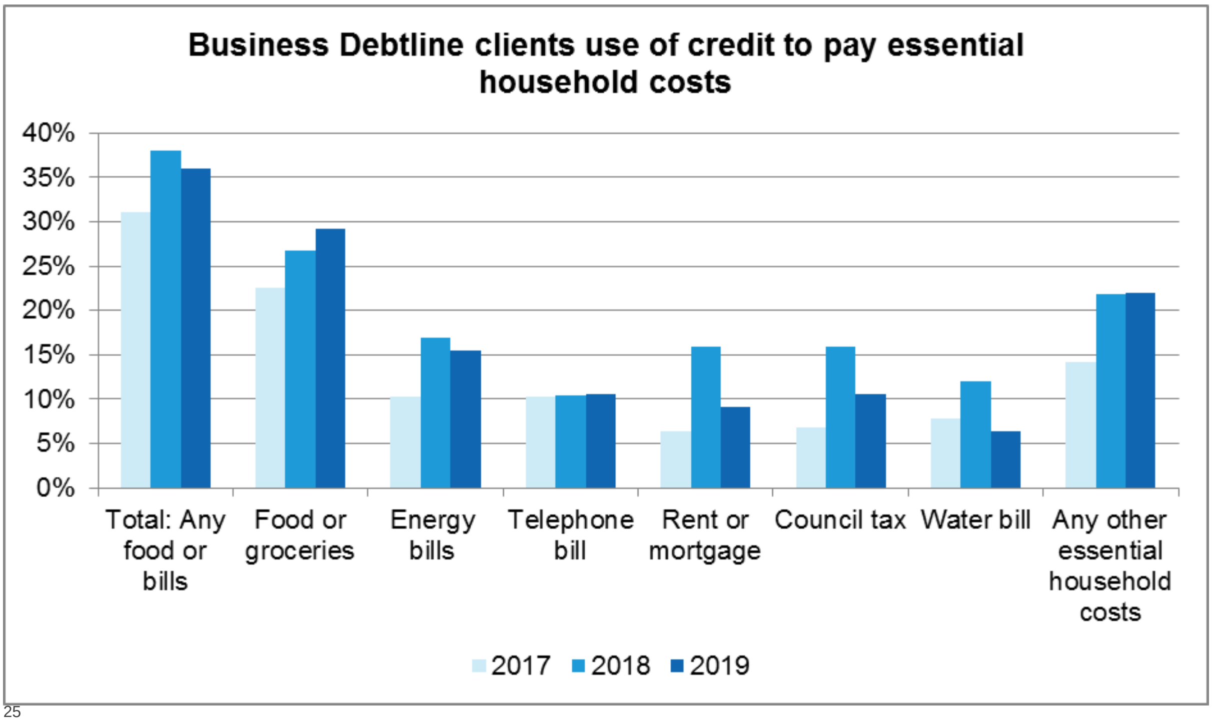
Through our services, we have also seen how Covid-19 has resulted in some people experiencing a change in circumstances. Since the start of the year we've seen an 8% increase in the in the proportion of people contacting National Debtline who are unemployed, and an increase in the number of people saying that job loss was the main reason for their debt (which now stands at 20% of National Debtline callers).[21]

As we set out earlier in our response, we know that some people are pushed towards using credit to pay for essential costs such as food and bills due to their income being too low for their needs. Research with National Debtline clients found that 31% had used credit to pay for food or household bills in the past two years.[22] The figure was 36% for Business Debtline clients.[23]



[24]

[20] Survey of 430 Business Debtline clients, conducted online in May 2020. For more information see: [At the business end: A spotlight briefing on the impact of Covid-19 on Business Debtline clients]
[21] National Debtline client records, October 2020.
[22] National Debtline annual impact survey, conducted online between 11 December 2019 – 11 February 2020. Base: 522 National Debtline clients.
[23] Business Debtline annual impact survey, conducted online between 11 December 2019 – 11 February 2020. Base: 219 Business Debtline clients
[24] National Debtline annual impact survey results. Base: 2019 – 522; 2018 – 740; 2017: 928.



[25]

With a significant proportion of the population currently living on reduced income – either due to being furloughed, having reduced hours, experiencing reduced trade or having lost their job and moved onto Universal Credit – we can unfortunately expect the number of people struggling to pay their essential costs to rise. This could drive an increased demand for credit from this group. However, use of credit to pay for essentials can quickly become unsustainable, particularly if people's incomes remain low and don't rise again quickly – putting them at risk of growing debt issues.

It is also worth noting that households who have experienced an income shock due to the coronavirus outbreak and who had savings are likely to have had to draw on these and, in some cases, use them up altogether. This will have reduced their resilience to cope with future income or expenditure shocks and could mean they are more likely to need to use credit in future.

People may well be relying upon their overdrafts to get by. The temporary £500 interest-free overdrafts introduced at the immediate onset of Covid-19 were a welcome and appropriate way of providing customers with a safety net. It is important that the manner in which this support is withdrawn does not inadvertently cause financial difficulty. The implementation of the new overdraft rates was put on pause at this point but this pause has now lifted. We do not feel that returning to such high overdraft interest levels will assist people who will have to bear a much higher cost of borrowing at a time when they continue to face the challenge of resolve financial difficulties resulting from Coronavirus.

In addition, the effect of Covid payment deferrals, and how these interact with the newly introduced persistent debt rules on credit cards have become very complex. We would welcome the FCA undertaking separate activity to clarify how the persistent credit card debt rules will work in the future as this has become very opaque. We suspect it will not be at all clear to either firms or consumers.

[25] Business Debtline annual impact survey results. Base: 2019 – 219; 2018 – 183; 2017: 204

The FCA Covid guidance is not specific enough relating to forbearance, as it leaves it open to firms to interpret their ability to be flexible and what forbearance options they offer in practice. It leaves it too open to different lenders adopting different approaches, which means that it will be unclear to consumers what to expect and a very real danger of a lack of consistency across lenders. It is unclear if firms will be required to be proactive in offering this type of flexibility or whether consumers will know they can ask their lender to take this approach.

We would like to see a more prescriptive approach from the FCA for firms, and enhanced supervision to ensure firms are interpreting the guidance correctly and treating their customers fairly. As it stands, if firms fail to use additional forbearance options, there is little clear compulsion on them to do so or sanction for failure to do so.

While we are better placed to comment on demand drivers, rather than supply, we note the recent Credit Conditions Survey by the Bank of England, in which lenders reported that the availability of unsecured credit to households decreased in quarter 3 and was expected to decrease slightly further over the next quarter.[26] Lenders also reported an expectation that demand for unsecured credit would rise in quarter 4.

If, as expected, Covid-19 leads to an increased demand for credit at a time when supply is constrained, then - as we explain in our answer to question 16 below - there is a real risk that this could lead to a further entrenchment of inequality within the credit market. However, it is important to remember that the solution to this issue cannot be simply to increase supply in riskier, more expensive parts of the market. Access to products that are unsuitable for people and which put them at increased risk of harm is not true access. Instead, as explored in our answer to question 9, we need to think creatively about new solutions - including government-backed schemes – that can give people safe access to credit.

Question 16: Do you think the impact of Covid-19 presents new or unique challenges for the unsecured credit market, or has it just emphasised or entrenched existing issues?

It is important to note that the drivers for credit use, and the causes of financial difficulty being experienced during the Covid-19 crisis are not in themselves new. People have always experienced life events – such as falling ill, losing their jobs or experiencing a bereavement – that have impacted upon their finances and led to problem debt for some. So the challenges of supporting people in financial difficulty or with unmanageable debt is not new, nor are the drivers for credit use. What the outbreak has done, however, is to increase the scale of the issue – with many people experiencing such challenges at the same time. It is vital that people with existing debt problems are not treated differently and granted less forbearance than someone who has a clearly distinguishable Covid-related debt problem. Many people will already have been struggling, or behind with their bills and will also need on-going support.

[26] Bank of England, Credit Conditions Survey – Q3, 15 October 2020

It is also important to note that the groups who have experienced the heaviest financial impact of Covid-19 are those who were already on low incomes or experiencing financial inequality or disadvantage. Research shows that those on existing low incomes, in insecure work as well as people who are black, Asian or from other minority ethnic communities have been particularly badly hit financially.[27] There is overlap here with groups that traditionally find it harder to access credit products that are affordable and meet their needs, suggesting existing issues around access could be exacerbated by the crisis. We are also concerned that these groups may be more likely to be forced towards higher-cost, more risky credit.

Finally, the impact of Covid-19 is clearly exacerbating inequalities within the credit market is perhaps seen most clearly in the data around repayment rates during the outbreak. Those who have remained in their jobs, and who have been able to work from home, have likely seen significant savings and this was reflected in net repayments on consumer credit across the UK between March – June, and again in September, with a record net repayment of £7.4 billion in April.

However, while it is clear that some people's financial position has improved, leading to record repayments and increased savings deposits for some, for others their experience has been nowhere near as positive. Research by Which? found that 780,000 people defaulted on a credit card or loan in October.[28] This was a rise of 370,000 people on the previous month – the sharpest rise since the start of the pandemic.

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[27] The Institute for Fiscal Studies, Covid-19: the impacts of the pandemic on inequality, 11 June 2020; IPPR, Black, Asian and minority ethnic groups at greater risk of problem debt since Covid-19, 24 September 2020.

[28] For more information, see: https://press.which.co.uk/whichpressreleases/which-research-suggests-huge-jump-in-number-of-people-missing-card-and-loan-payments-as-financial-support-cut-back/

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