Call for input: Review into change and innovation in the unsecured credit market – the Woolard Review

Money and Pensions Service response

The Money and Pensions Service welcomes the opportunity to provide evidence and views to this Call for Input into change and innovation in the unsecured credit market. As an organisation supporting people to make the most of their money and pensions, we have focused our responses on the questions focused on the areas of consumer benefit and potential for consumer detriment from the unsecured credit market.

Executive Summary

- The UK Strategy for Financial Wellbeing[1] published by the Money and Pensions Service last January identified five key agendas for change to support consumers to make the most of their money and pensions, including reducing the nine million people who regularly use credit for everyday bills.
- As we develop proposals to meet this goal by 2030, we have commissioned two key pieces of research from Bristol University's Personal Finance Research Centre to understand who uses credit in this way, and why. This provides some useful insights into the causes of problematic credit use, including both low and fluctuating incomes, as well as wider drivers such as low financial capability and over confidence.
- Emerging developments in credit need full evaluation of their impact on consumers, including in particular the rise of Buy Now Pay Later as a method of payment that can be seen to encourage increased spending, and equally the rise of the salary advance market that presents some distinct advantages in avoiding the use of credit but can also develop into problematic use.
- Our work on the strategy has highlighted the need to support more consumers to access lower cost mainstream credit, with a clear need for Credit Referencing Agencies to take wider factors into account in developing credit ratings, and for financial services firms to consider the nature of their lending decisions. The FinTech sector has developed significant market innovation to improve ability to borrow for consumers with thin credit files, and the learnings for mainstream lenders should be considered.
- Access to affordable credit is key to low income consumers and MaPS supports the plans by Fair4All Finance to address capacity in the sector and raise awareness with consumers.

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[1] https://www.moneyandpensionsservice.org.uk/uk-strategy-for-financial-wellbeing/

- Consumers require access to credit throughout their lives in response to life events or new plans, and this Review will need to understand the extent to which any tightening of eligibility or affordability criteria runs the risk of driving more consumers to illegal or informal lending, as we have seen with the large numbers of consumers 'borrowing from friends and family' to cope with Covid-19 related financial uncertainty.
- The longer-term financial impact of Covid-19 on consumers is likely to create significant challenges in access to credit for many consumers and the FCA will need to consider whether firms may need additional guidance to allow them to balance the proportional assessment of risk and responsible lending.
- The FCA's work to support consumers with the Covid-19 related guidance to firms has introduced significant support and there are areas, including both lenders offering repayment plans for people with high overdraft or credit card debt, and in offering tailored support to meet those with longer term financial difficulties, that would merit broader application beyond the Covid-19 immediate response.
- Both in the immediate aftermath of Covid-19 and later, it will be important that firms signpost customers to debt advice as soon as it becomes apparent that they are struggling or juggling a number of debts.

About Us

The Money and Pensions Service (MaPS) exists to help people make the most of their money and pensions. We were created by the Financial Guidance and Claims Act 2018, bringing together the Money Advice Service, the Pensions Advisory Service, and Pension Wise under one body.

The Money and Pensions Service is an Arms-Length Body, sponsored by the Department for Work and Pensions, with a vision of 'Everyone making the most of their money and pensions' by ensuring that people throughout the UK have guidance and access to the information they need to make effective financial decisions over their lifetime. We deliver this by means of:

- Pensions guidance - to provide information to the public on matters relating to workplace and personal pensions.
- Money guidance - based on customer journeys that are designed to enhance day-to-day money management skills and understanding of financial matters, allowing consumers to make better decisions
- Debt advice - to provide people in England with information and advice on debt.
- Consumer protection - enabling us to work with Government and the Financial Conduct Authority (FCA) in protecting consumers.
- Strategy - work with the financial services industry, devolved authorities and the public and voluntary sectors to develop and coordinate a national strategy to improve people's financial capability, help them manage debt and provide financial education for children and young people.

Detailed responses to questions:

Theme1 – Drivers and Use of Credit

Q1: 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 customers***

In January 2020, MaPS published the UK Strategy for Financial Wellbeing[2]. This identified five agendas for change to improve the financial wellbeing of the UK population by 2030:

- Financial Foundations – more children and young people getting a meaningful financial education;
- Nation of Savers – helping working-age 'struggling' and 'squeezed' people to save regularly;
- Credit Counts – working to ensure fewer people need to rely on credit to buy food or pay bills;
- Better Debt Advice – increasing the number of people accessing debt advice when they need it; and
- Future Focus – helping people to understand what they need to know to plan for later life.

In relation to credit, we recognised that whilst use of credit, to smooth out expenditure and income, and to support people through life events and plans, was an essential part of our financial lives, using credit for everyday essentials was a reflection and driver of poor financial wellbeing. Our 2018 Adult Financial Capability survey[3] of 6,000 adults in the UK provided evidence that an estimated nine million people very or fairly often use credit for food and bills, and in our strategy, we set a national goal for reducing this figure by two million people.

The full data sets of our survey are available from the UK Data Archive but in 2020, we commissioned Andrea Finney of the University of Bristol's Personal Finance Research Centre (PFRC) to explore the characteristics of that group of an estimated nine million people, before considering three identifiable sub-groups. The PFRC report[4] describes these three sub groups in terms of their borrowing behaviour and their demographic, socio-economic and financial characteristics. Even in relation to the use of unsecured credit for every day bills, this reflected that whilst this was driven by necessity for two of the sub segments who were on very low incomes, for the third group with higher

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[2] https://moneyandpensionsservice.org.uk/wp-content/uploads/2020/01/UK-Strategy-for-Financial-Wellbeing-2020-2030-Money-and-Pensions-Service.pdf

[3] https://www.fincap.org.uk/en/articles/financial-capability-survey. The full data sets of our survey are available from the UK Data Archive

[4] http://www.bristol.ac.uk/media-library/sites/geography/pfrc/Analysis%20of%20the%20credit%20counts%20national%20strategy%20measure.pdf

incomes and the most complex use of credit, over confidence and low financial capability were also significant drivers.

Building on this work, in July 2020 we commissioned PFRC to carry out a literature review on the theme of "Why Adults regularly use credit for food and bills"[5] This review, which also covers wider credit use themes, draws on research evidence from the last five years to explore the socio-economic, financial and other factors which have been considered in the literature as drivers for use of credit. It ends by considering the likely impact of COVID-19 on the use of credit to pay for food and bills. The research suggests that low income and low financial resilience are important factors, but other reasons also emerge. The focus of this research is not exclusively on the use of credit for everyday bills so has wider relevance to this Call for Input.

This research identified that "*Using credit (specifically a credit card) for food or other living costs is more than twice as likely among those with low incomes as the average*." But also, that "*Volatile incomes (low-paid insecure work, e.g. zero-hours, short-term contracts, or fluctuations in benefits payments) are particularly problematic. People with unpredictable incomes are at least than twice as likely to have used overdrafts (and incurred charges on these) and five times more likely to have used high-cost credit than those with stable incomes*." This recognises that the growing proportion of people in the workforce on precarious incomes[6], including those working in the gig economy and employed under zero-hour contracts, will increase the number of consumers using credit to cope with income variations and drops, often experienced on a frequent but unpredictable basis.

Supply side interventions also have a significant role to play, and the research" recognises *that credit card design and marketing encourage borrowing. Marketing has also been shown to encourage re-borrowing among higher-cost credit customers*." We have also seen how supply side interventions can support firms to encourage people to repay borrowing earlier, and pay less interest overall, with work such as the Fairbanking Foundation's work with Capital One showing the potential to nudge consumers to make higher credit card repayments (report attached as Appendix 2) and MaPS' own current trial with a firm and the Behavioural Insights Team to examine the potential of credit card sliders to increase repayment levels.

At the other end of the process, Fair Finance have recently carried randomised control trials that demonstrated the potential to encourage people at the point of applying for credit to borrow less by anchoring of the default loan application amounts, setting the default amounts for loans to lower amounts. This has shown significant impact on reducing the overall amount borrowed and merits further consideration.

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[5] http://www.bristol.ac.uk/media-library/sites/geography/pfrc/Why%20adults%20regularly%20use%20credit%20for%20food%20and%20bills.pdf

[6] https://theconversation.com/one-million-britons-will-be-on-zero-hour-contracts-by-end-of-2020-132338

The FCA's recent analysis of relending in the high cost credit market identified a key role in marketing by firms, resulting, according to the FCA's consumer research, in significant regret experienced by consumers after taking out further high cost loans. Whilst the FCA identified a number of themes in publishing that work in August 2020, the recommendations have some way to go to protect consumers from the actions of firms and we would urge the Woolard Review team to revisit this evidence.

Whilst our work on the Use of Credit in the UK Strategy for Financial Wellbeing has focused on the use of credit for everyday bills, the Challenge Group established to consider how to tackle this issue has also considered the matter of more 'avoidable' use of credit, as the third consumer segment using credit in this way is using a wide range of credit so that their financial resilience is impacted and they are driven to use credit for everyday bills. In this context, the group has considered the rise of the Buy Now Pay Later phenomenon, and the way this model risks exploiting behavioural biases to encourage consumers to over commit, with a particular marketing emphasis on younger consumers. We hope that the Woolard review will consider the implications of this emerging form of deferred payment, and how it is influencing behaviours and attitudes relating to excessive credit use and the normalisation of debt as a 'standard feature' of consumers' financial lives.

In particular, we would ask the Woolard review to consider the levels of fees and charges for missed payments in Buy Now Pay Later, the extent to which these are transparent to consumers, and also the fact that these transactions do not provide consumers with Section 75 protection.

Q2: what are the main trends and challenges created by these changes?

In response to the increasing prevalence of consumers on volatile incomes, we have set out how people increasingly rely on credit to address periods of lower income or respond to particular life events. Partly in response to the needs of such employees, the Employer Salary Advance Scheme (ESAS) market has also developed significantly over the last few years with a significant proportion of large employers offering such schemes to their staff. These can play a helpful role in allowing low income workers or those on fluctuating incomes to access cash to deal with emergencies or respond to life events. They present the advantage that they allow someone to use only what they have already earned, thereby not accessing credit, and to borrow only as little as they need.

However, these facilities can become problematic if they become a 'repeat use' solution and consumers end up in a cyclical advance scenario, preventing them from meeting other financial commitments.[7] Again, this is an evolving area for how people substitute the need for credit that would merit scrutiny by the Woolard Review so that

[7] Equally, further research is needed to explore patterns of use in terms of 'in-month frequency' and the stage in the pay cycle that users draw down, as these will enable cost comparisons with loan interest rates.

we can understand more about its impact on consumers and whether any regulatory constraints should be imposed.

In September, we produced the attached briefing paper (Appendix 1) for our own internal review, providing a brief snapshot and analysis of the current salary advance and salary-based loans market, and we are sharing this as a context for considering this market. When reviewing the range of products/services offered across the market, the distinction between advances of accrued salary and loans facilitated via the employer repayable from salary should be borne in mind. The views expressed in this briefing do not represent a formal MaPS policy position but were intended as a contribution to discussions about how we frame relevant products within our overall programme of money guidance offered to the public. They may provide some helpful insights to this Call for Input.

Q4: 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 have outlined our insights on this point in response to question 1.

Q5: 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?

Our investigation into the use of credit for everyday bills as part of our UK Strategy development work has recognised that one of the ways to mitigate this behaviour is to reduce the overall cost of credit for consumers, and to improve access to mainstream credit for more consumers who are currently excluded from the market. The work of our Challenge Group has recognised that more work needs to be done to address this by:

- Encouraging credit referencing agencies to allow for the reporting of a wider range of data sources so as to allow people with thin credit files to build credit histories, building on existing approaches developed by, for example, Experian and Equifax, and on emerging challenger FinTech credit referencing firms.
- Reviewing the impact of the six-year impairment markers on credit files with the Steering Committee on Reciprocity to ensure that these are still fully appropriate, and to consider whether some of those markers should have a more reduced impact on credit files.
- Considering credit decisioning processes adopted by financial services firms and identifying opportunities to broaden access to mainstream credit.

The impact of the Covid-19 crisis on both markets and consumers has highlighted the barriers faced by many people in accessing mainstream credit, and we have seen those who have been furloughed and/or taken payment deferrals struggling to secure further credit, despite the information held by credit referencing agencies being unaffected.

We are particularly concerned that certain consumer groups have been disproportionately financially affected by the pandemic, including people from ethnically diverse communities who have been over represented in affected sectors.

The problems these consumers are likely to face in accessing credit increases the need for data disclosure from firms on the protected characteristics of those to whom they lending, and those that are declined. Fair Finance have set an important example in this regard[8] and with a view to delivering the Public Sector Equality Duty, we would urge the FCA to consider this issue as part of this Review. The Covid-19 has deepened existing inequalities to such an extent that this issue must now be considered.

The publication of findings from the FCA's long awaited study into the credit information market will be key to understanding how the market is working for consumers, and the extent to which consumers are being excluded and left with no alternative to high cost credit, borrowing from family/friends or informal/illegal lending.

FCA data on the impact of the pandemic on households, and the solutions adopted by consumers who are struggling financially, have highlighted the role that 'borrowing from friends and family' has played in supporting people to get through the crisis. It is well understood that the line between borrowing from 'friends' can also blur into illegal money lending.

The FCA carried out a factual review to shine a light into the issue a couple of years ago, but this is a dynamic market that responds to consumer behaviours and much of the activity is moving online. The UK's Illegal Money Lending teams in each nation are doing important work to understand this activity and have been building evidence into the 'victims. A review of unsecured credit needs to include consideration of this activity, too often a recourse for those who have no other options but are still confronted by a broken washing machine or car, and there are worrying signs that risk averse mainstream lending post Covid -19 could drive more consumers to this type of credit. Whilst challenging, the Review should consider the role of illegal lending and what potential there could be for greater monitoring and enforcement of such activity.

Q6: 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?

The risk of this assumption is, as set out in response to question 5 above, that those people with no access to credit will still require support to deal with an emergency. Those on low incomes will inevitably need credit at times, whether they can access it or not, unless they have built up a savings safety net. Whilst building savings is also a long-term objective of our UK Strategy for Financial Wellbeing, in the meantime those without access to credit will be at risk of more serious detriment.

[8] https://www.fairfinance.org.uk/map/data-disclosure/

Theme2 – Change and innovation in the supply of credit

Q7: Please provide evidence and/or views on:

a. ***The main areas of change, innovation and growth in the supply of unsecured credit.***
b. ***The key pressures and challenges to the sustainability of firms supplying unsecured credit, including how these have changed over time and how they might develop in the future.***
c. ***New and emerging business models, including those making use of behavioural biases and income from other sources than the end consumer (e.g. employers, retailers) and how existing models may be adapting to change.***

We have set out in response to question 1 our concern about the growing BNPL market exploiting behavioural biases to encourage consumers to purchase more than they might have had they been immediately charged the cost of an item. Alongside those emerging payment types, we are also seeing a significant growth in vertical credit providers like Amazon Credit who offer credit alongside their main business activity. Together with BNPL, PayPal Credit and Sage Pay, these developments are increasingly encouraging consumer spending and use of credit and may make it difficult for an individual to gain a clear and full picture of all their current and forthcoming commitments.

Q9: 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 effects 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***

Our view is that there continue to be gaps in consumers’ awareness of and access to affordable credit offered by credit unions and CDFIs, and we are fully supportive of the work of Fair4All Finance to focus on this. Raising such awareness, and improving capacity for the sector to meet demand will form an important pillar of our work on credit in the UK Strategy for Financial Wellbeing.

As evidenced by the growth in the salary finance market, the workplace is becoming an important entry point for consumers to access credit, and we believe that this is an area where the role of credit unions could also be developed further, possibly with further legislative change to overcome barriers on credit broking, as we have seen in relation to social housing referrals into credit unions.

Theme 3 – the role of regulation in unsecured credit markets

Q12: How could changes in the market drive incentives which do not align to consumer interests?

The regulatory change on overdraft charging alignment introduced in April 2020, albeit delayed by the impact of Covid, has broadly resulted in typical overdraft charges settling at an interest rate of around 40%. This trend highlights how customers with overdrafts are subsidising free retail banking in the UK, and whilst the FCA's impact assessment of the effects of introducing these changes was that 80% of consumers using overdrafts would be better off, we are still concerned that a significant proportion of account holders will be carrying significant debt burdens if they are unable to repay their overdraft.

The numbers impacted will have significantly increased following the Covid-19 related financial crisis, and we welcomed the FCA's guidance to firms that at the end of subsidised overdraft offers in response to Covid-19, firms should seek to offer tailored repayment plans to customers with high overdraft balances. We believe that offering such individualised arrangements should become an explicit and BAU requirement and added to current CONC overdraft repeat use requirements. This need has been made more urgent by the increasingly risk-averse lending behaviours that we have seen since the pandemic, as this will mean that customers with large overdraft burdens risk will be unable to secure lower interest rate loans to pay off those overdrafts

We are also concerned that even before Covid-19 added to the strain, the introduction of the overdraft charging regulatory changes at the same time as the credit card persistent debt remedies were introduced will impose a significant obligation to repay two sets of credit commitments for people who are already struggling. We believe that the ongoing review and monitoring of both sets of persistent debt remedies should ask firms to identify and support those customers they believe to be affected by both.

Q14: Are there gaps in data or the way information flows in the current market that create problems for consumers or lenders? How might these be addressed?

In our view as commissioner of debt advice, a key gap exists in the way that some lenders deal with people who start to experience payment difficulties. With only information about the debt owed to that particular lender, lenders may insist on unrealistic payment arrangements that will not be sustainable and could plunge the customer deeper into financial difficulties. Best practice would see lenders refer customers to debt advice where it becomes clear that a customer is experiencing financial difficulties or/and is in debt to more than one creditor. The Money Advice Service Creditor Best Practice Toolkit provides guidance to creditors on how to support their customers and encourages creditors to either refer a customer to the Debt Advice

Locator Tool[9] or to establish robust referral pathways for customers to high quality free to customer debt advice such as MaPS Money Adviser Network.

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

Q15: 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 impact of Covid-19 has been polarised, with some consumers able to reduce borrowing where they have retained a steady income and reduced living costs, whilst many others have experienced serious difficulties. The FCA's own data on how consumers have met the impact of Covid-19 related financial difficulties has highlighted the number of consumers who have sought payment deferrals and the number who have borrowed more. It is much harder to get a full picture of how many have increased overdraft commitments and with a long-term return to average 40% interest payments, this is particularly worrying.

MaPS does not have specific evidence in relation to the affordable lending sector, but our money guidance Contact Centre and social media channels have seen significant evidence that people who have had payment deferrals or been furloughed are struggling to secure access to credit. Although FCA guidance mandated credit record masking of payment deferrals, it is apparent that lenders can often identify deferrals (e.g., in cases where there has been a pause in monthly payments registered) and in making their own creditworthiness assessments are taking these factors into account and refusing credit to consumers who have made use of deferral opportunities. Anecdotally, the high cost lending sector has also retrenched, so that many consumers are struggling to access credit at present.

Covid-19 has created a particular challenge for firms in dealing with consumers: the number of consumers who have been financially impacted, and the ongoing precarious employment in many sectors of the economy, mean that financial services firms are struggling to reconcile responsible lending and a recognition of consumer circumstances. In our Use of Credit Challenge Group, lenders have suggested that the FCA needs to consider new guidance for firms on how to strike a balance between lending to those consumers who have or may yet be financially impacted by Covid-19, and responsible lending. Without new guidance that reflects the unprecedented situation that the market finds itself in, there is significant risk that large numbers of consumers will be unable to borrow for some time.

[9] https://www.moneyadviceservice.org.uk/en/tools/debt-advice-locator

Q16: 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.

The impact of Covid-19 does both, emphasising existing issues as we have seen that those people in poorly paid jobs, with the least financial resilience, have been most impacted by job loss and furlough. However, the new challenge is the level of debt burden that many of those low-income consumers will carry long into the future, as new borrowing and payment deferrals increase interest payments and tip some consumers into deficit budgets.

MaPS is currently developing modelling to anticipate the impact of this on the demand for debt advice, but many consumers will not reach the stage of needing debt advice but struggle with significant credit commitments for a number of years before, in many cases, tipping into actual default. The extent and impact of this is still unclear as we face uncertainty about the medium- and long-term trajectory of the pandemic. Referring consumers into money guidance as soon as it becomes clear that they are struggling financially will be key to securing better financial outcomes.

Q17: Do you think any of the measures set out in the FCA's temporary guidance for consumer credit, including those related to credit information and forbearance, or the FCA's wider approach have broader relevance to customers in financial difficulty more generally?

MaPS has welcomed the FCA's approach to supporting consumers in financial difficulties over the last eight months, and we are gratified by the opportunities the FCA has provided for us to contribute to its emerging thinking on payment deferrals and what comes after. The FCA have sought to fully understand the situation facing consumers impacted by the coronavirus pandemic and balanced their needs with the requirements of a functional credit market.

We believe that current approaches specified by the FCA are indeed highly relevant to the future treatment of consumers in financial difficulty, and that firms' wider and ongoing approach to forbearance where it is required should incorporate a tailored approach to working with consumers, taking individual circumstances into account and agreeing sustainable repayment arrangements. We would welcome the Woolard Review considering what support for consumers in financial difficulty should look like over the coming years, with many consumers likely to experience long term difficulties and the demand for debt advice and solutions likely to outstrip supply for some time unless increased debt funding is maintained.

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