FCA Practitioner Panel

FCA Practitioner Panel Response to Review into Change and Innovation in the Unsecured Credit Market (Woolard Review)

1st December 2020

Introduction

We welcome the Woolard Review and believe it provides the opportunity to take stock of the significant regulatory and technological change that has taken place in recent years and help prepare the market for future challenges resulting from the pandemic.

The FCA's interventions in the unsecured credit market have delivered significant benefits to consumers: the payday lending cap protected many borrowers from escalating debts; the removal of unarranged overdraft charges has reduced the cost of unsecured credit for many customers; and persistent debt remedies in credit cards have made it easier for consumers to pay down debt. Improvements in digital capabilities have allowed providers to offer innovative services and consumers to access unsecured credit more flexibly. However, many regulatory interventions have been made vertically and incrementally on a product by product basis. In order to effectively improve customer outcomes, regulation would benefit from looking across the unsecured landscape horizontally, and, given this, we welcome the approach to this review.

A Healthy Unsecured Credit Market

A healthy unsecured credit market plays a critical role in supporting the wider economy. It allows customers to take greater control of their finances and gives them more flexibility over how they spend and save. A healthy unsecured credit market requires:

- **Credit that is affordable.** Consumers can access credit they are able to afford at fair prices that recognise their cost and risk to serve.
- **Access to credit safely.** Consumers can access credit and borrow to responsible levels. This should be designed to avoid default borrowing e.g. Buy Now Pay Later (BNPL).
- **Transparency, fair value, choice and effective competition**. Providers of unsecured credit compete for customers by offering innovative products and services that increase consumer choice.
- **Support for customers to help them avoid financial difficulty and support once they enter financial difficulty.** The market provides effective and coordinated support to indebted and vulnerable consumers who are in financial difficulty.
- **A holistic regulatory framework.** This framework should balance the objectives above and ensure the principles of regulation are consistently applied so that there is a level playing field between different providers and products. It should also ensure a common approach and avoid contradictions between different regulators. Regulation should also support simpler customer journeys and help promote innovation and the use of digital services.

There is more that can now be done to improve the health of the unsecured credit market.

1. **Access to affordable credit for underserved groups can be expanded**

   Customers for whom credit is not appropriate: There are customers for whom credit unfortunately will not be the answer. They may have difficulty with their finances or be unable to afford paying anything more than the principal of any lending they take out. Some customers, may not even be aware that they have taken out debt (e.g. BNPL). For this group we need to look at international examples, like Australia, where there is strong collaboartion between the Government, industry and micro-finance providers. Innovations such as the Non-interest loan scheme should be looked at and potentially developed in the UK. Fair for All Finance have begun to look at this and we recommend this work be given the support of the FCA and use of the FCA Sandbox if appropriate.

   Customers who are creditworthy but not able to take out credit or engage in the process: For these groups it is important to expand the reach of credit unions. Again Fair for All Finance are taking forward ideas to scale the community finance sector. HMT's Affordable Credit Challenge, working with NESTA, is also finding ways for community finance providers to partner with fintechs.

   There are a number of other interventions that the Review should consider to improve access for creditworthy customers who do not have access to credit, including:

   - **Improve customer understanding and use of credit reference data:** CRA data and how it is used continues to be an area of confusion for customers. Different lenders use different agencies and it will not always be clear to the customer which one their proposed lender might be using and how customers can improve their chances of securing credit.

   - **Leverage new data sources for making credit decisions**: Despite significant efforts many consumers in the UK remain unable to access credit because of insufficient data or an unfavourable credit history. The FCA could build on the Credit Information Market Study to explore the potential to use new data sources, such as rental payments and information held by local and central government, to help customers with insufficient information on their credit files. This is important as where the lender does not have the required data aspects of the affordability assessment must be modelled which may reduce the chances of the customer being lent to. The FCA's work should also explore how to give CRAs greater responsbility for correcting mistakes in customers' data which may also act as a barrier.

   - **Improve cost calculators and eligibility checkers**: Some customers can find it difficult to locate personalised information on the availability and cost of credit. More can be done to enhance calculators and eligibility checkers to better serve customers who struggle to access affordable credit.

- **Simpler customer journeys**: Lengthy and complicated pre-contract agreements impede consumer understanding and prevent lending under traditional credit products. They also harm customer engagement. The FCA should consider how the CCA and CCD can be amended post-Brexit so that consumers benefit from increased simplicity.

- **Help the innovation and the development of new products**: The use of credit builder products, such as deposit-backed credit cards, may be another way to improve access. These products are more popular in the US and the Review should look at ways to expand their use in the UK. Similarly, the Review could look at installment cards and examine whether there are regulatory barriers to their development.

2. Greater support and protection for customers to stop unaffordable lending

New forms of credit such as 'Buy Now Pay Later' or Employer Salary Advance Schemes (ESAS) have now taken the role of payday lenders in providing credit to customers who might not be able to get access to mainstream credit.

Not all these providers provide credit and, therefore, undertake regulated activity. However, given the potential for customer harm the Review should consider how the scope of regulation chould be expanded as part of its annual work which looks at the regulatory perimeter, including:

- bring credit-like activity (e.g. ESAS) into the scope of the regulatory perimeter;

- where regulated activity is undertaken in BNPL and elsewhere the Review should recommend that this is made clear to the customer in the journey and that affordability assessments are strengthened;

- identifing particularly harmful practices that occur across products, e.g. using a credit card to secure BNPL; and

- ensuring all credit products are appropriately plugged into CRA reporting, on a near real time basis, to avoid unaffordable borrowing.

- greater clarity on what the FCA determines 'responsible lending' both at inception and through time, to ensure that products are available to access via simple customer journeys. Including without the requirement for a full income & expentiture, as potentially expected by the Financial Ombudsman, but without significant retrospection risk. This would increase the provision of 'mid-price' credit in a safe way without significant risk.

3. Greater support and coordination for customers before and when they enter financial difficulty

Problem debt was a significant and growing issue in the UK prior to the Covid crisis, and is expected to get significantly worse.

The FCA's approach to regulation of consumer credit has so far focused on reviewing and implementing remedies on a product-by-product basis. While these interventions might benefit consumers in the narrow context of one product, they do not provide the right remedies for customers using multiple products across multiple providers and can create unintended consequences in how consumers use credit products more widely. For example, remedies aimed at improving customer engagement with individual credit products risk overloading consumers with information and notifications leading to a reduction in a consumer's overall engagement. Regulation should aim to think across credit products.

HMT's remedies under Breathing Space are welcome interventions for helping customers in need and will help customers in problem debt who have to deal with multiple creditors across different industries. Does the Review consider it would be helpful to undertake a step back review of the debt advice market and whether it is delivering the best possible outcomes?

4. Ensuring the business models of distributors and lenders are driving the right behaviour and ensuring a common appoach to a range of key areas

In recent years the FCA has looked in detail at the business models and strategies of major market participants through its firm facing supervisory work. It has combined this with market study activity which has helped identify commission models which pose harm to customers and amended rules and guidance on the disclosure of commission arrangements to ensure consumers receive appropriate information on commission and how it impacts the amount they pay. The most recent example of this was in the motor finance market where the FCA banned the use of discretionary commission models.

We recommed the FCA undertakes thematic work to identify any drivers of harm in the business models of new entrants, for example, those that rely on commission from merchants and ensures that where regulated activity is undertaken new entrants are following rules and guidance around commission disclosure.