High-cost Credit Review – update

January 2018

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1 Introduction and our emerging approach

1.1 In July 2017 we published a Feedback Statement[1] setting out our response to the Call for Input we issued in November 2016[2]. In that Feedback Statement, we set out our decision to retain the cap on high-cost short-term credit (HCSTC), commonly called the pay day loan cap, at its current level for a further three years. We also published a detailed analysis of consumption patterns of an array of products, including arranged and unarranged overdrafts, and other high-cost credit products. In the Feedback Statement, we identified a number of issues which could cause consumer harm, and committed to investigate those further with the aim of issuing a Consultation paper with proposals for addressing our concerns in Spring 2018.

1.2 This document gives an update on progress and our direction of travel, and indicates the further work we are undertaking and the planned timelines for that work.

1.3 We cover the specific products that we have identified as areas of concern. These are arranged and unarranged overdrafts (see Section 2), rent-to-own products, home-collected credit and catalogue credit (Section 3). We have been gathering further evidence from firms on these products and consumer research is currently being completed.

1.4 In July, we also identified we needed to carry out further work to understand the challenges to those supplying alternatives to high-cost credit. We have already published a summary of roundtables we hosted to explore these issues[3], and in Section 4 we set out the issues we have identified and the actions we are considering. These include actions that we can undertake ourselves. It also includes issues where we intend to work with other parties.

1.5 There is an emerging picture of a case for possible intervention in a number of markets but also a recognition of the limits of what can be achieved through traditional regulatory interventions alone. Looking at the shape of the overall market and considering how choices for consumers might be widened is therefore important context as we work towards consultation on a series of issues later this year. In particular, in certain parts of the market we will seek to intervene to encourage alternatives to high-cost credit, particular those from the 'mid-cost' market.

1.6 It should be noted that we have a number of concerns about outcomes for consumers of high-cost credit products, including overdrafts, but we have not yet reached any final conclusions or decisions, either about the existence and extent of any consumer harm, nor have we decided whether, or how, to intervene. Where we consider we need to introduce new rules to address any harm we identify, we will carry out full consultations, taking into account the findings of related work that the FCA is undertaking, in particular as part of the Strategic Review of Retail Banking, to give stakeholders the opportunity to comment on what changes might be made.

1 FS17/2: High-cost credit and review of the high-cost short-term credit price cap, available at: https://www.fca.org.uk/publications/feedback-statements/fs17-2-high-cost-credit

2 Call for input on high-cost credit and review of the high-cost short-term credit price cap, available at: https://www.fca.org.uk/publications/calls-input/high-cost-short-term-credit-price-cap

3 https://www.fca.org.uk/publication/research/high-cost-credit-review-feedback-roundtables.pdf

1.7 Our approach to high-cost credit can be summarised as having four main components:

- **We authorise, supervise and enforce** against our existing rules -we have already taken significant action where firms have not met our rulebook including creditworthiness and treating customers fairly. We are using the process of authorisation created by the transfer of regulation to the FCA to ensure that firms meet existing standards. We have today issued a further update on our work in this regard in the rent-to-own sector.

- **We are prepared to intervene and propose new rules** where we have the evidence that markets are not working well for consumers.

- **We can promote competition and innovation in the interest of consumers** by encouraging new business models that better serve consumers, and addressing rules that might be preventing markets from working as well as they could.

- **We can work with others to influence the demand in markets** thinking about what drives demand for high cost credit, the alternatives and how consumers can build basic financial resilience.

2 Overdrafts

2.1 Overdrafts can provide a convenient way to help consumers manage both day-to-day finances and income and expenditure flows over longer periods of time. In our Feedback Statement, we explained our concerns about arranged and unarranged overdrafts. In particular, we said that "we believe that there is a case to consider the fundamental reform of unarranged overdrafts and whether they should have a place in any modern banking market".

2.2 Since publishing the Feedback Statement we have carried out a detailed analysis of the way consumers use their overdrafts. To do this we have used a rich dataset with the transaction history of 1.5m Personal Current Accounts (PCA) held at the six largest UK PCA providers. This information covers a two year period from January 2015 to December 2016.[4] Our analysis has shed light on the patterns of intensity and persistence of arranged and unarranged overdraft use.

2.3 We need to complete significantly more analysis before we can reach any final conclusions about whether consumers suffer harm from their use of overdrafts. This is the current focus of our work. However, the evidence we have gathered to date reinforces our concerns about unarranged overdrafts.

Emerging findings

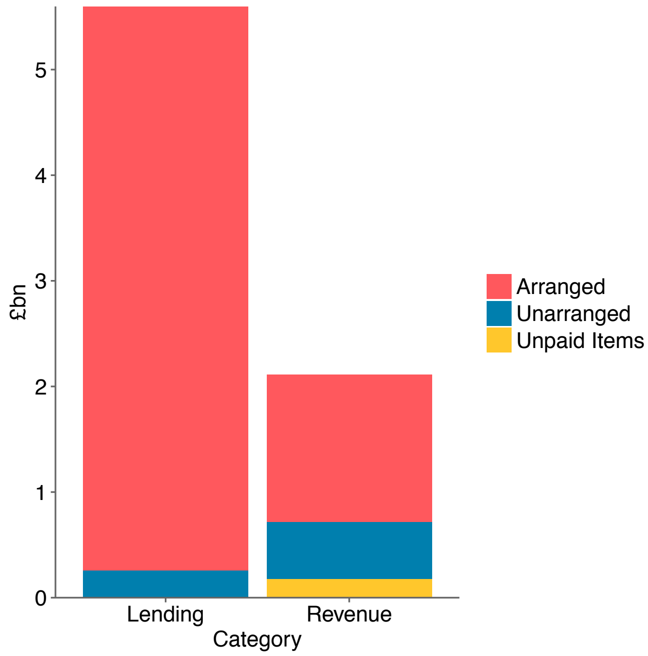
Unarranged overdrafts

2.4 We remain concerned about the high fees and charges for unarranged overdrafts, especially when compared to the relatively small amounts lent. Analysing the data from some of the larger PCA providers shows that, while arranged overdrafts are a larger source of revenues than unarranged, the proportion of revenues from unarranged is significantly higher compared to the amounts lent out.

2.5 Data received from the five largest PCA providers show that annual revenues from unarranged overdrafts, excluding unpaid item fees, were around 200% of the average amount outstanding in 2016, with a range of 100-440% between the five firms. For arranged overdrafts it is around 25%, with a range of 14-38% between the firms (See Figure 1). Although we are still evaluating the costs involved in lending through arranged and unarranged overdrafts, we find it difficult to see that that the difference between arranged and unarranged revenues is purely due to lenders' costs. Unarranged overdraft fees and charges also appear to be highly concentrated: while around 20% of PCA accounts received charges for using an unarranged overdraft in 2016, over half of the charges were concentrated on just 2% of accounts.

4 We note that there have been some changes in the market since December 2016. We will be taking these into account in our overall analysis.

Figure 1 – Average amount outstanding and gross revenue from arranged and unarranged overdraft charges for 2016[5]

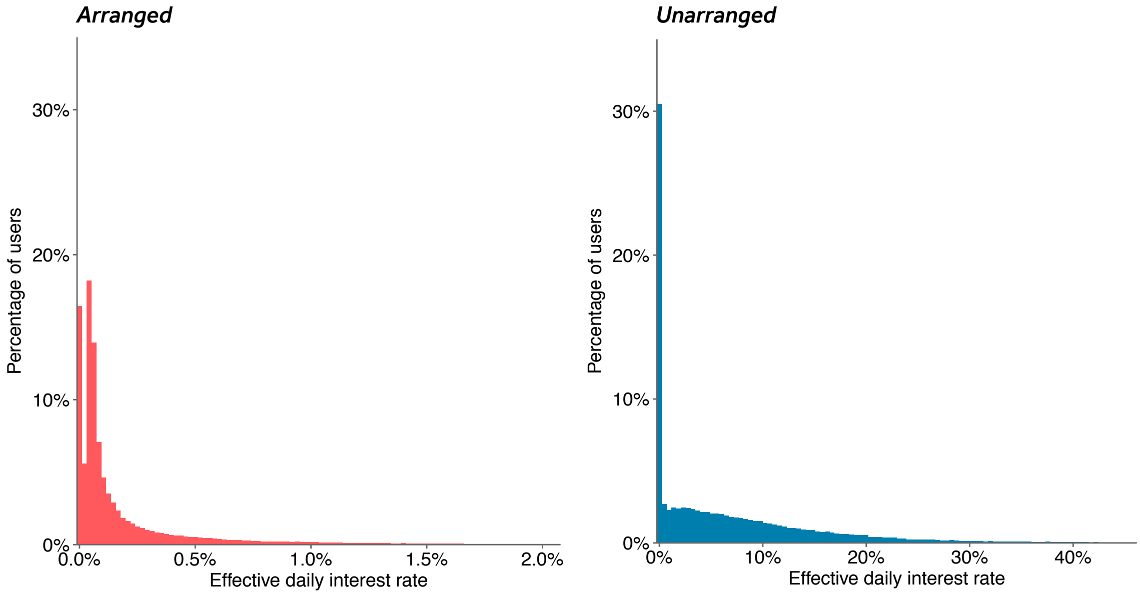


2.6 The high revenues on lending through unarranged overdrafts are partly explained by fixed daily fees which can be large compared to the amounts borrowed. The majority of unarranged borrowing is under £50, so a typical fee of £5 a day can amount to 10% (or more) of the amount borrowed. In contrast, the HCSTC price cap limits interest and other charges to 0.8% per day, or 40p a day for a £50 loan. While we must be careful when comparing two such different products, the fact that unarranged borrowing fees and charges can be over 10 times those of HCSTC indicates that the market might not be working well for consumers.

2.7 We are also investigating how charges relate to individual customers' actual use. We took a sample of 250,000 customers at each of several major PCA providers and analysed their patterns of overdraft use over 2016. Through looking at the amount each customer borrowed, and for how long, we calculated an effective daily interest rate for each customer. Figure 2 shows the distribution of the effective daily rates the consumers in our sample were charged and highlights significant differences between charges for arranged and unarranged overdrafts.

5 The chart is based on data collected from the five largest PCA providers using a random sample of 250,000 accounts at each firm. 'Revenues' is the total amount charged to consumers across 2016. 'Lending' is expressed as the average daily amount outstanding across 2016, so represents the amount lent through overdrafts, split between arranged and unarranged, on an average day of 2016. We have used this measure to give a picture of the overall stock of overdraft lending since most overdraft borrowing is short term (a few days) and it is in line with the approach taken by firms when quantifying their levels of overdraft lending.

Figure 2 – Distribution across different customers of effective daily interest rates for arranged and unarranged overdraft charges for 2016 [6]



2.8 The results to date show that:

- For arranged overdrafts, consumers generally pay fees and charges that appear to be correlated with the amounts borrowed and the length of time they were borrowed for. There is some variation in this between firms. This can be seen in Figure 2 through the way the effective daily interest rates are bunched together within a relatively narrow range.

- For unarranged overdrafts, we see no clear relationship between how much is borrowed and what is charged, as may be expected due to the fixed daily charging structure used by many firms. This leads, in part, to the large variation of outcomes for different consumers seen in Figure 2.

2.9 As a result of these findings, and separate from the issue of level of charges, we are considering whether we should act to simplify charges to ensure they are clear and better reflect actual use.

2.10 We have also identified that a significant proportion of charges for unarranged overdrafts are linked to consumers using unarranged overdrafts repeatedly or persistently. Between 30-65% of unarranged charges are paid by consumers who used their unarranged overdraft over 15 times in a two year period. We are concerned that repeated use of an unarranged overdraft may cause harm to the consumer, and may be exacerbating existing financial difficulties. We are conducting further research into this using data we have collected from credit reference agencies. If we find that firms' incentives are poorly aligned with those of their customers we will consider whether we should intervene in the market to address this. There are several alternative approaches which we could take and our analysis will identify both the extent of harm and the most effective way to remedy it.

6 The 'effective daily interest rate' is calculated by taking the amount charged to customer over 2016 for their (un)arranged overdraft use and dividing it by the number of days spent in overdraft multiplied by the amount borrowed. Please be aware of the difference in scales between the two charts.

Arranged overdrafts

2.11 A similar picture of persistent usage is also emerging for arranged overdrafts. We looked at consumers who used their arranged overdraft every month in 2015 and 2016. We found that 6.5% of PCA accounts fell into this group and that they paid around half of both arranged and unarranged overdraft charges. On average, these consumers are in their arranged overdraft 85% of the time. Using the credit reference data we have collected, we will analyse whether heavy and persistent users are exhibiting signs of financial distress and take into account their use, and the availability, of other credit products. We are also looking at whether consumers use overdrafts as a substitute for other forms of credit. We will then consider whether we need to intervene to protect consumers from harm linked with persistent overdraft use over a long period.

Next steps

2.12 Our work on overdrafts in the High-cost credit review is just one of our priority areas of research into retail banking.

2.13 We are undertaking a Strategic Review of Retail Banking Business Models ('the Strategic Review') to better understand retail banking business models and how free-if-in-credit banking is paid for. We are looking particularly at whether free-if-in-credit banking leads to concerns about the distribution of profits from different types of consumers or different products.[7] The Strategic Review will provide us with valuable insight into the interlinkages between different elements of the PCA and retail banking products.

2.14 Following the Competition and Markets Authority's investigation into retail banking, we are working to promote competition in this market. In particular, our research includes trials of prompts and alerts to improve consumers' engagement with their overdraft use and charges and their awareness of the potential benefits of switching. We will report these research findings and may make proposals for consultation in the May publication. We will also report on our review of the effectiveness of the PCA providers' Monthly Maximum Charges - caps that PCA providers have to set on their total monthly charges from unarranged overdraft use. Any proposals we make as a result of the High-cost credit review will take account of the impact these remedies may have.

2.15 While we have seen evidence of harm, we are undertaking extensive further analysis that will enable us to identify which consumers suffer harm, the extent of that harm and what might be most effective approaches to resolving it without unintended consequences. This includes analysis of credit reference agency data and consumer research that we have commissioned to inform our assessment of the potential harm. We will publish the results of this analysis and evidence gathering in May 2018.

2.16 Arranged and unarranged overdrafts cannot be considered in isolation of one another or of the wider PCA offering. So we will need to undertake careful analysis to ensure that any action taken to remedy issues in one area does not lead to harm elsewhere. To reduce the risks of unintended effects, we will use the evidence and insight from the Strategic Review to inform the exact design of any wider package of remedies. We will therefore look to consult on any further remedies towards the end of 2018 taking into account the findings of the Strategic Review.

7 FCA (2017), Strategic Review of Retail Banking Business Models: Purpose and Scope, available at: https://www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-scope.pdf

3 Other high-cost credit products

3.1 In our Feedback Statement, we identified three products we had concerns about as a result of our research and the responses to our Call for Input. These were: rent-to-own; home-collected credit; and catalogue credit products.

3.2 In this update we give further detail on the particular issues that we are focusing on in relation to these products. We are gathering further evidence, both from firms and through consumer research, to inform our final assessment of harm to consumers and what actions may be necessary and appropriate to address this.

3.3 We aim to report on this further analysis in May. If our further research confirms our concerns regarding these products, we will consult on proposals to address these harms at that point.

The role of high-cost credit

3.4 In the high-cost credit review, we have been considering the role of credit for financially vulnerable consumers, their options and the implications for regulating high-cost credit products.

3.5 Credit is not the right option for all consumers. There is a group of consumers who are on such low or uncertain incomes or whose personal circumstances mean that any lending is likely to be inappropriate or unaffordable. Parts of the social welfare system are designed to provide assistance to them.

3.6 There is another group of consumers who are on low incomes and may be financially vulnerable but are nontheless able to sustain low repayments for small sums. However, the personal circumstances of these consumers can mean they are especially susceptible to unexpected changes to their income or expenditure demands, for example dealing with changes to their living arrangements at short notice. Reflecting risk of default, borrowing for these consumers is particularly costly, potentially further decreasing their ability to meet their wider financial obligations and increasing risk of harm from the consequences of default. This is particularly the case where they need to borrow to obtain essential household goods, such as a fridge or washing machine.

3.7 Our view is that the provision of credit can nevertheless have a socially valuable function. High-cost credit users typically have low credit scores and many do not have savings but may need credit to make ends meet and avoid wider financial difficulties (e.g. default on household bills or priority debts). They may also have very limited options for obtaining essential goods or for managing other larger purchases or bills. Consumers can benefit from using high-cost credit where repayments are sustainable and appropriate forbearance is shown if they have temporary repayment problems.

3.8 There is a spectrum of credit products and pricing across the consumer credit sector aimed at different consumer circumstances and needs. High prices for lending to sub-prime customers are driven, to an extent, by the underlying economics of serving these customers.

3.9 Making small loans over relatively short periods is inherently higher cost. It can also be costly to assess the risk of lending to customers with thin credit files. Certain product features mitigate the higher risks for firms that their customers miss payments or default on loans. An example of this is the rent-to-own model which means that firms retain ownership of goods during the contractual term, although the resale value of those goods may be limited.

3.10 However, within the different types of products available, we see examples of some providers that appear commercially viable while charging consumers significantly less than other providers. This suggests that we could take steps to help increase consumers' awareness of the alternatives that are available and help them make better choices. We would also be willing to work with potential providers, not just CDFIs and credit unions but banks, building societies and other commercial innovators to explore new and innovative approaches to responsible lending, including adapting and using our FCA Innovate team and the regulatory Sandbox. This could include looking at a number of issues including:

- Access to capital.
- The availability of mid-cost credit – which may be above prime borrowing rates, but below the HCSTC cap level.
- Information and promotion of alternatives.

3.11 Overall, we have a responsibility to ensure there is a framework of rules which firms comply with which reduces the risk of consumer harm but allows the provision of credit where it is appropriate and affordable. Our interventions have resulted in a transformation of some high-cost sectors. Substantial improvements have been made by firms, in particular in their creditworthiness assessments and dealing with consumers in financial difficulty.

3.12 In some high-cost credit markets, we consider there may be a need for additional rules and guidance. These are explained further below.

Rent-to-own

3.13 During 2016, 200,000 people took out a rent-to-own product, and 400,000 had outstanding rent-to-own debt at the end of 2016.[8] For those that took out rent-to-own products in 2015 and 2016, the debt these consumers held on these products was over a third of the overall debt they held, and was significantly larger than debts they held on any other types of product, which suggests that people who use rent-to-own products have fewer options available to them.

3.14 Our analysis indicates that rent-to-own customers are a particularly vulnerable group of consumers. In 2016 they had a median annual income of £16,100. Taking into account all the debt held by these customers and recorded on credit reference files, the median amount of outstanding debt more than doubled from £2000 in November 2014 to £4300 in November 2016.

8 FCA analysis of representative sample of CRA records, 2013-2016.

3.15 Our authorisations and supervisions work have driven significant improvements in this sector which have reduced the risk of consumer harm. We have been examining how much more consumers pay when they obtain goods through rent-to-own than if they bought them in high-street stores or using other credit or hire options. We acknowledge that there are higher costs associated with hire purchase, but the costs we are seeing are particularly high in some cases.

3.16 We are gathering further evidence on prices and firms' pricing policies including add-ons such as insurance and warranties, which have a substantial effect on the overall amounts consumers pay. We have previously examined the extent to which behavioural biases can affect the choices consumers make in relation to add-ons.[9] We are concerned about the impact of these costs on consumers' finances and that they do not consider the costs or value of these products before buying them.

3.17 The high costs that rent-to-own firms charge, particularly for essential goods, have led us to explore the limited availability of alternative credit options for certain consumers, which could otherwise provide a cheaper, lower risk alternative option. We discuss this in Section 4 below.

Home-collected credit

3.18 Our analysis indicates that home-collected customers have similar characteristics to rent-to-own customers. In 2016 the median annual customer income of this group was £15,500. The median amount of their total outstanding debt more than doubled from £1200 in November 2014 to £2800 in November 2016, with a quarter of this in home-collected credit.

3.19 The home-collected credit market is larger than the rent-to-own market. 700,000 people took out a home-collected credit loan in 2016. 1.6 million people had outstanding debt on these products at the end of 2016, with a value of £1.1 billion. Home-collected credit customers also appear to hold debt in home-collected credit products for a long time – many of the consumers who borrowed using home-collected credit at any point between 2012 and 2016 were still borrowing at the end of 2016.[10]

3.20 We are focusing our evidence gathering on repeat borrowing and refinancing, including where consumers take out additional borrowing with the outstanding amount from the previous loan incorporated into the new loan. We are concerned that when consumers refinance their loans in this way, it may result in them paying significantly more interest on the amounts originally borrowed than they would had they maintained separate loans.

3.21 We recognise that there is value for consumers in having continuing access to home-collected credit and maintaining additional weekly repayments on separate loans may not be affordable. We are, however, examining if repeat borrowing could work better for consumers. We have requested data from firms on their lending patterns and nature and extent of refinancing, and have also commissioned consumer research to explore

9 See for example, https://www.fca.org.uk/publications/market-studies/general-insurance-add-ons-market-study
10 High-cost Credit Review Feedback Statement, Technical Annex 1, p.79.

consumers' experience of home-collected credit and their understanding of the cost implications of refinancing and repeat borrowing.

Catalogue credit

3.22 Our analysis confirms that catalogue customers have slightly higher median annual income than consumers of home-collected credit and rent-to-own products: £17,700 in 2016. The median amount of outstanding debt increased substantially from £300 in November 2014 to £1300 in November 2016, and debt held on catalogue credit is a smaller share of debt than credit card debts, unsecured personal loans and motor finance.

3.23 Catalogue credit products differ from rent-to-own and home-collected credit. Consumers using catalogue credit are drawn from a wider socio-economic group and have on average higher credit scores than other high-cost credit products. This is reflected in the wider range of pricing. However, we still have concerns about catalogue credit products and are continuing to analyse and gather further evidence on these products to get a clear picture of the outcomes for consumers using these products.

3.24 Online shopping has blurred the boundaries between traditional credit products, and we are considering what that means for catalogue credit. To get a broader view of consumers' use of similar credit products, we have included store cards in our consumer research.

3.25 We have concerns that the apparent complexity of catalogue products - including their charging structures and repayment options and choice architecture - may mean that consumers do not fully understand key features and so may not be making informed choices. We are exploring if this effectively channels consumers down routes that make it more likely they will pay higher interest charges and increase likelihood of arrears. We are gathering more evidence on firms' policies and practices, including information they provide to customers, as well as commissioning consumer research to better understand consumer use of these products and their impact.

Next Steps

3.26 We aim to report on this further analysis in May and should this further research confirm our concerns regarding these products, we will consult on proposals to address these harms at that point.

4 Alternatives to high-cost credit

4.1 This section reports on the work that we have undertaken to understand and identify ways to address barriers that may prevent greater availability and awareness of the alternatives to high-cost credit.

4.2 We held a series of roundtables and meetings with stakeholders to explore alternatives to high-cost credit. We published a summary of our roundtable discussions in December 2017.[11] Below, we cover the issues raised in these discussions and the steps we will take to address them.

4.3 We recognise the value of high-cost credit for consumers who lack other options, where firms have made appropriate assessment of their creditworthiness. However, we are also exploring why relatively lower cost, mid-price, lower risk credit options are not more widely available. We have been looking at barriers to the provision of alternatives and have been considering what might be done to address these.

4.4 We do not foresee that alternative credit will fully replace high-cost credit. However, increasing the likelihood of making alternative options available will help reduce the risks of poor outcomes for some consumers, in particular through reducing the incidence of people paying more for a product than they would with an alternative provider.

Alternative credit options

4.5 There are currently two main alternative sources of credit for higher-risk consumers: community development finance institutions (CDFIs) and credit unions.

4.6 CDFIs are not-for-profit consumer credit lenders, established for social purposes to provide credit to low income consumers. There are currently less than a dozen personal lending CDFIs of varying size. In 2016-17, they lent a total of £22 million to around 55,000 consumers.[12] This compares with total lending of £600 million to around 200,000 consumers for rent-to-own alone. Although some CDFIs have achieved cross-region reach or take online applications, small marketing budgets and localised operations limit their financial capacity and their ability to raise consumer awareness of their products.

4.7 CDFIs must be authorised by us in order to provide regulated consumer credit and are subject to the same rules as commercial credit providers with the exception of the high-cost short-term credit rules (although they must still meet a high threshold to be permitted to carry out this lending). Prices are generally lower than for commercial credit providers serving the same consumers but are still significantly higher than credit prices for borrowers with higher credit ratings.

11 https://www.fca.org.uk/publication/research/high-cost-credit-review-feedback-roundtables.pdf
12 Responsible Finance Annual Industry Report 2017 http://responsiblefinance.org.uk/policy-research/annual-industry-report/

4.8 Credit unions are mutual societies which take deposits and make loans. They have to demonstrate, among other things, a common bond between their members, such as living in a particular geographical area. There are 464 credit unions across the UK with a total of 1.8 million members. There are a number of legislative constraints on credit unions which protect their members including a lending interest rate cap. Nonetheless some of the larger credit unions have broadened their lending bases to include higher-risk consumers.

4.9 In some cases, both CDFIs and credit unions have offered lending alongside other partnerships with money or debt advisers. There seems to be some evidence of this approach reducing default rates.

What are the barriers to expanding alternative credit?

4.10 Drawing on the research we have undertaken and the extensive stakeholder discussions held during the course of this review, including the roundtables we held and reported on last year[13], we have identified some key issues that act as barriers to the expansion of alternatives to high-cost credit.

Access to sustainable capital

4.11 There is a fundamental challenge in providing alternatives to high-cost credit, since the costs and risks of providing small loans to high risk consumers are high. This makes it more difficult to achieve a sustainable funding model without reliance on grants and donor funding. We believe the sector needs to be self-sustaining in order to offer the prospect of expansion and long term service to consumers rather than reliance on grants, although we have seen evidence of pump-priming being effective. As the sector is able to demonstrate its track record we would expect the costs of financing to become more predictable. A number of stakeholders are calling on Government to reduce the risks of investing in the sector by subsidising a proportion of losses or by providing tax incentives to incentivise investment.

Alternative credit as a financial inclusion tool

4.12 Firms have told us that they face a reputational risk in this sector. Credit is not universally accepted as a useful service for the financially vulnerable. Investors, donors, local authorities and others who might otherwise help in expanding the reach of alternative credit schemes can be wary of extending credit to high-risk borrowers and the risks of increasing indebtedness. In some of our roundtables we heard views expressed by some that interest rates in double digits were unacceptable, but these will be needed to fund the sector on a commercial basis.

Varying appetite and capacity amongst credit unions to lend to higher risk consumers

4.13 Credit unions are diverse with different risk appetites and capacity to expand their lending into higher risk groups. Some larger credit unions successfully partner with CDFIs, alongside other local-level not-for-profit partners, but there is no easy route to replicating this. We would see any initiatives as principally for the larger credit unions.

13 https://www.fca.org.uk/publication/research/high-cost-credit-review-feedback-roundtables.pdf

Uncertainty about regulatory requirements

4.14 Stakeholders told us that use of alternative credit works best for the financially vulnerable as part of a package of support services. However, they have suggested that uncertainty about the regulatory boundary and requirements can deter support services from making referrals.

Connecting at key moments

4.15 There is a lack of resources, infrastructure and knowledge to connect with consumers at the key moments which drive demand for high-cost credit. Part of the demand is driven simply by consumers moving in at short notice to unfurnished social housing tenancies. While there are some successful schemes set up by local authorities and other registered social landlords (RSLs) to provide essential goods to tenants, there is no formal or widespread mechanism for sharing best practice and expertise. A fear of the burden of regulatory requirements may act as a barrier to RSLs setting up such schemes.

Costs and utility of data

4.16 Alternative lenders face significant costs for access to creditworthiness assessments and identity verification. Credit reference agency (CRA) data may not give lenders a clear picture of the circumstances of high-risk applicants, particularly those with little credit history or where there are gaps in CRA reporting such as rental data and non-bank income. This increases alternative lenders' reliance on costly manual assessments and makes it more difficult to make quick lending decisions.

What actions can we take to lower some of these barriers?

Innovation and the Regulatory Sandbox

4.17 As noted above, we believe action we take on high-cost credit has to aim both to remove the worst harms for consumers, but also to change the market by encouraging innovation. We seek to encourage this, including opening our regulatory Sandbox to experiments aimed at developing new business models in this space that are in the interests of consumers.

Access to sustainable capital

4.18 There needs to be a long-term, sustainable solution to raise capital for alternative credit. We will engage with social investors, the banking industry and other commercial investors to understand their appetite for and concerns about investment. We are keen to explore ways to promote long term, commercial capital in this space and to identify whether there are regulatory barriers that prevent the market working well. We are exploring lessons from other jurisdictions and how these could be applied in the UK. We would be open to innovative thinking in this space, for example, different ways in which credit union capital could be made available to support lending by CDFIs. We will discuss with Government whether there are mechanisms for de-risking or incentivising investment which could support sustainable growth in alternative credit.

Alternative credit as a financial inclusion tool

4.19 We believe that access to alternative credit options can be an important aspect of measures to promote financial inclusion. However, they need to be targeted at the right group of consumers, as some consumers would be better served by budgeting help or debt advice. Alternative credit options should only be provided by firms lending responsibly. We have a key role to play in building confidence in alternative credit options by monitoring and enforcing firms compliance with conduct standards.

4.20 We would welcome the consideration of alternative credit in financial inclusion initiatives developed by central, devolved or local government, the private sector or charitable organisations. For example, the Government recently announced[14] it intends to provide around £55 million over the next four years to financial inclusion and capability programmes in England. These programmes tackle issues such as problem debt and improve access to financial products and services for those on lower incomes. The funds will come from dormant bank and building society accounts via the Big Lottery Fund. This may present an opportunity for supporting alternative credit initiatives.

Varying appetite and capacity amongst credit unions to lend to higher risk consumers

4.21 We welcome approaches from credit unions interested in expanding their lending or, within the legislative boundaries, partnering with CDFIs, to discuss their ideas with and look at how we can help in assessing the regulatory implications.

4.22 More generally, we would be willing to work with potential providers beyond the credit union sector, including banks and building societies, to discuss new ideas and innovative business models that could expand responsible lending options available to consumers beyond those currently available.

Uncertainty about regulatory requirements

4.23 Local authority activities are excluded from the definition of credit broking. This means they may, therefore, refer consumers to credit unions or CDFIs without the need for authorisation for credit broking activity.

4.24 The situation for other organisations is more varied depending on the circumstances but we can set out clearly what is required of RSLs and others alongside where authorisation is or is not required, and what it involves. We will provide clarity to local authorities and other organisations such as RSLs and housing charities on the scope of regulation when they refer people to credit unions or CDFIs. We will also look to streamline the process for authorisation where this is appropriate. There may also be scope to modify the regulatory boundary, and we will discuss this with Government.

4.25 Our intention is that this supports referrals at critical moments when consumers need credit such as when they approach a local authority seeking help to purchase essential household goods.

Connecting at key moments

4.26 We will encourage replication of successful initiatives by RSLs for acquiring essential household goods by highlighting some successful examples of schemes and highlighting relevant legislative and regulatory requirements. We are exploring the possibility of collaborating with Government to include guidance on issues outside our remit and ensuring this is publicised nationally.

14 Press release, 'Government unlocking £330 million from dormant accounts to build a fairer society', 4 January 2018: https://www.gov.uk/government/news/government-unlocking-330-million-from-dormant-accounts-to-build-a-fairer-society

Costs and utility of data

4.27 We will explore how credit data services can better serve the interests of high-risk consumers and the scope for enhancing the sources and range of CRA data to assist firms in creditworthiness assessments (e.g. on rental payments).[15] We recognise that this is a complex area and some stakeholders highlight wider data sharing carries risks for some consumers.

Basic financial resilience

4.28 One of the biggest drivers of the need for credit is that around a third of households in the UK have no savings. In addition to considering alternative credit models, we have also seen impressive results from Money Advice Service (MAS) programmes to assist those on low incomes to build a basic safety net of a savings pot to handle emergencies. Whilst we recognise this will not be possible for every consumer, we will be working with MAS and the Financial Capability Board to see if more can be done here. In particular, we note experiments by major banks with FinTech to able to offer simple savings accounts at low cost and programmes by some credit unions to encourage basic savings.

Next steps

4.29 We will consider the options to improve transparency of regulatory requirements and give a further update in our consultation paper in May, including further guidance and rule changes if necessary.

4.30 More generally, we will continue our discussions with firms, Government and other stakeholders on these issues and welcome further engagement on what we or others could do to foster alternative credit options.

15 In the Autumn Budget 2017, the Government announced the Rent Recognition Challenge - a £2 million Prize Fund, open to all, challenging new firms to develop new applications, or build on existing ones, to enable rental tenants to record and share their rental payment data with lenders and credit reference agencies. Further detail on the scheme can be found here: https://www.gov.uk/government/publications/rent-recognition-challenge-using-fintech-to-help-renters

Separately, the Creditworthiness Assessment Bill [HL] 2017-19 is a private member's bill introduced by Lord Bird which received its second reading on 24 November 2017. The Bill would provide that rental payment history and council tax payment history were taken into account when assessing an individual's creditworthiness. The Bill's timetable can be found in the following link: https://services.parliament.uk/bills/2017-19/creditworthinessassessment.html

5 Next Steps

5.1 We will publish a substantive update in May this year that will set out our analysis and assessment of harm from the high-cost credit products on which we are focusing in the review. At that stage we also intend to consult on changes that we may propose to improve the operation of those markets, and in particular to promote competition for and to protect consumers of these products. This will include measures to promote competition and consumer engagement following the CMA's retail banking investigation and details on the actions we have taken to increase the availability of alternatives to high-cost credit.

5.2 In relation to overdrafts, we will set out the conclusions from our analysis of potential consumer harm in May and the nature of any remedies that we consider might be warranted in the light of that analysis. Detailed assessment of those potential remedies will follow, taking into account the analysis of retail banking business models being undertaken as part of the Strategic Review. Any proposals we consult on will be published later in 2018.

5.3 We will continue to engage with stakeholders to explore the issues in the sector and ways in which we could support a sustainable supply of responsible lending to consumers, including how we might facilitate the development of new business models that could improve outcomes for consumers.

5.4 We welcome comments on this update and thoughts on the issues and areas for further work set out. Please contact us at highcostcreditcfi@fca.org.uk.

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