Financial Conduct Authority

High-cost credit review: Feedback from roundtables

Introduction

1. This paper summarises the issues and ideas raised by participants in our roundtables. These points do not necessarily reflect the views of the FCA, but participants in the events. They are one source of evidence that the FCA may use to inform its views. We are now considering the issues raised further with a view to identifying opportunities for increasing access to alternatives and make recommendations in our Spring Consultation Paper.

Executive summary

2. On 31 July 2017 we published a Feedback Statement[1] which set out our priorities for the next stage of our review of the high-cost credit sector. We explained that we are particularly concerned about rent-to-own, home-collected credit and catalogue credit, as well as wider concerns about consumers' long-term indebtedness. We also explained that we would take a leading role in supporting collaboration to share best practice and foster innovative thinking in relation to provision of alternatives to high-cost credit and would convene a forum to encourage cross-agency public policy solutions.

3. We hosted three roundtables in September and October. These covered two areas: a general discussion of alternatives to high-cost credit and a focused discussion on the provision of essential goods. A number of key themes emerged from the discussion which can be summarised as follows:

    1) Accessing capital is a major challenge for alternative lenders. Raising awareness of the social benefits could encourage investment from social investors.

    2) Alternative lending is most effective as part of a complete package of services. Exploring the scope for partnerships across public agencies and the financial services industry would increase the range of assistance available to consumers.

[1] https://www.fca.org.uk/publications/feedback-statements/fs17-2-high-cost-credit

3) Greater clarity about the regulatory boundaries and compliance with regulatory requirements could support more cross-referrals at a community-level to providers of alternatives to high-cost credit.

4) There is scope for exploring measures by public bodies that could be taken to reduce the cost of accessing data and to fill gaps in traditional data sources.

5) There are opportunities for public bodies and others to take a greater advocacy role in raising awareness about alternative lending.

6) Social housing providers' provision of essential goods to tenants can be encouraged through delivery of clarity about funding sources, a clear pathway to delivery and the social benefits.

4. We are now further exploring the issues raised in the discussions with stakeholders with a view to making recommendations in our Consultation Paper in Spring 2018.

Introduction

5. Our regulatory interventions are transforming the high-cost credit sector, delivering improved conduct standards and better outcomes for consumers. Where our interventions lead to firms restricting their lending, there are questions about the consequences for consumers who are no longer able to access credit. We also recognise that borrowing for low-income, high-risk consumers, even in a well-regulated sector, remains costly and the consequences can create harm to consumers. There are therefore limits to what we can achieve with regulatory intervention and we consider that action is needed from a range of stakeholders to support consumer access to alternatives. For example, some housing associations and local authorities provide tenants with white goods and other basics.

6. As a starting point, we held two roundtables in September in London and Edinburgh to take forward the discussion about alternatives to high-cost credit by identifying viable alternatives and barriers to their adoption and expansion.

7. We held a further roundtable in London with a specific focus on supporting people to access alternatives to (high-cost) credit for the provision of essential goods.

8. <u>We are grateful to the participants for their valuable contributions and collaborative and supportive approach to the discussions.</u>

Alternatives to high-cost credit

9. This paper summarises the issues and ideas raised by participants in our roundtables. These points do not necessarily reflect the views of the FCA, but participants to the events. We are now exploring these further and aim to identify opportunities for increasing access to alternatives and make recommendations in our Spring Consultation Paper.

Theme 1: alternative lenders face challenges in accessing commercial capital at a reasonable cost and accessing capital that covers first losses.

- Many alternative lender participants highlighted the challenges of raising capital to scale up provision. It was noted that as well as the difficulty of attracting offers from investors, often commercial investors expect a high return from their investment, which many alternative lenders may struggle to meet. Participants also highlighted that there are no tax concessions for investors to personal lending firms or tax relief to mitigate against potential financial loss.

- One participant highlighted that commercial funding sources are often not in a position to cover first loss which presents a challenge for alternative lenders that may have outgrown funds and grants from the social sector. It was suggested that there is a need for a form of catalytic grant to leverage first investment which currently does not exist in the UK in a centrally coordinated large scale form.

- Several participants indicated that in contrast to commercial lenders, many alternative lenders do not charge additional costs in the form of fees, insurance, warranties, or mark-up cost price at commercial rates. As a consequence, they often struggle to cover bad debt.

- Some participants suggested that there are partnering opportunities for credit unions to work with Community Development Financial Institutions (CDFIs) but noted that the framework constrains well-capitalised credit unions leveraging their capital. Participants also highlighted that credit unions can only lend to members - with limits on the numbers of corporate members and the amount the credit union can invest. These restrictions limit the scope for indirect lending by larger credit unions through lending to CDFIs. Some participants called for a review of these restrictions. At the same time there was recognition that the risks might outweigh the reward in the absence of a loan guarantee and for smaller-scale community credit unions.

- Participants suggested that the case for social enterprise capital needs to be better made so that potential philanthropic and commercial lenders receive a better business case to 'sell' to their shareholders/donors. They noted that whilst banks might not have the brand appetite to get into this market, match funding could be provided if the case was better understood. This would require the provision of greater insight into the business models of alternative lenders, how the market is segmented, the social benefits of investment to service multiple solutions and ways of measuring success. Some commented that CDFIs may pay more for investment capital because they are seen as being risky, so de-risking needs to be part of the picture.

- Some participants highlighted the benefits that social enterprise capital could provide where this was not dependent on seeing a financial return. The Good Shepherd Finance scheme in Australia was cited as an example of a successful alternative lending scheme where capital injection by the National Australia Bank to Good Shepherd Finance was assisted by a tax concession to write off its bad debt. There were calls for a similar tax concession in the UK.

- The point was made it is a misconception that credit unions are 'alternatives to high-cost credit' – they are 'alternatives to credit' more broadly. It was suggested that the credit union model would not be sustainable if too heavily used by the highest risk borrowers.

- One participant raised doubts about the capacity of alternative lenders to provide credit on a large scale because the mechanisms for achieving economies of scale such as automated processes and online applications create new challenges for building supportive relationships with consumers. It was suggested that small steps are likely to be more effective than upfront injections of capital into a sector that does not have the capacity to effectively leverage it. It was also suggested that there needs to be consideration of the starting point and to see the solution as part of a longer term process requiring consistency and persistence.

Theme 2: alternative lending is most effective as part of a wider package of services.

- There was support for the idea that alternative lending needs to be linked with other support services, such as debt advice, grants, personal budgeting assistance as well as other income smoothing options such as payment flexibility for utility bills, council tax etc. It was suggested that local authorities will be encouraged to take an interest in fostering CDFIs if they see alternative lending as part of a preventative strategy, complementing advice and support networks and drawing people in before they reach crisis point. This could help make a case for government/local government support of alternative lending where societal benefits are accruing more widely (e.g. avoiding stress and health problems associated with indebtedness). It could also help the delivery of existing financial inclusion programmes at a local and national level with one participant suggesting that there is currently a lack of tangible action, consistent planning and with variable alternative lending provision.

- Participants noted some successful partnerships with mainstream banks in providing seamless access to savings and current accounts alongside alternative lending and it was felt that there was opportunity for such initiatives to be adopted more widely. One participant highlighted that this was an important issue as credit unions and CDFIs often cannot afford technology and accessing payments systems is difficult and costly.

- One participant suggested that one of the attractions of high-cost credit is that lenders appear to give certainty to applicants that they will be successful in securing a loan. It was suggested that certainty about securing an alternative loan could be conditional on an applicant agreeing to get debt advice.

Theme 3: clarity about the regulatory boundary and compliance with regulatory requirements could support more cross-referrals and reduce barriers to community-level provision of alternatives to high-cost credit.

- Many participants expressed uncertainty about inadvertently crossing the boundary into regulated credit brokerage or debt advice by referring to other organisations/services. Also concern was expressed on the complexity and costs of doing regulated lending activity. There were calls for greater clarity and targeted guidance, with worked examples and templates to alternative lenders and partners to assist understanding of the requirements and their responsibilities.

- A few participants advocated the need for proportionate regulation, suggesting that a more flexible approach was required for alternative lenders compared with commercial lenders. Authorisation costs and capital weighting were cited as examples where flexibility should be adopted to reflect the cost burden on alternative lenders.

Theme 4: data sharing or verification by government/local authorities could support alternative lenders to reduce costs of accessing data and fill gaps in traditional data sources. There are opportunities for exploring new types of information about consumers that could support their access to alternative lending.

- Participants noted that getting access to accurate data at a reasonable cost was a barrier to expansion but also questioned whether credit reference agency data could give a complete picture of the highest risk consumers. It was highlighted that certain debts, such as gambling debts, can only be seen on bank statements, requiring a more costly in-depth affordability assessment. There were suggestions from participants that government/local government could play a role in assisting with access to data, such as verifying benefits income and validating identification.

- One participant highlighted that with the advent of the second Payment Services Directive and Open Banking, there will shortly be an opening up of bank account data. It was suggested that this will contribute to better risk-based decisions and the matching of credit to affordability. Further, that for those without bank accounts, or thin credit files, data-sets will wrap up data including on renting and social media, to build statistical models to help lending decisions.

- A few participants expressed contrary views. Reference was made to research which suggested that data sharing does not help low-income households. Concern was expressed that data sharing could lead to unintended consequences, such as behavioural changes, whereby some people prioritise consumer credit over essential expenditure. It was also suggested that people do not access their credit score and may struggle to understand data and that an increased volume of data may not therefore be necessarily helpful.

- Some participants noted that dealing with higher-risk borrowers can mean higher costs in contacting and keeping in touch with them. It was proposed that creative solutions are needed to see how credit reports could reflect whether a consumer had a history of actively engaging with their lender.

- One participant called for a different approach to data to reflect softer issues such as vulnerability and life-limiting conditions. It was suggested that this type of information could also assist with building the social investment case.

Theme 5: There are opportunities for public bodies and others to take a greater advocacy role in raising awareness about alternative lending.

- There was debate about the value of large scale public awareness raising campaigns with some participants arguing that a national approach was needed to raise awareness of the sector amongst consumers and address the stigma that alternative lenders face. Others argued that there are complex reasons why people make financial decisions and use particular lenders which are difficult to shift and rely on building trust and relationships. However, it was agreed that ultimately consumers need to be aware that there is a choice.

- Some participants suggested that the government adopt a national advocacy role to raise awareness and provide reassurance to consumers, investors and alternative lenders that the alternative lending sector is credible and that alternative lending could be part of a joined-up solution to support vulnerable consumers.

- At an individual level, participants highlighted that alternative lenders cannot afford the same levels of expenditure on advertising and marketing as commercial lenders. They may be more reliant on local advertising or social media where content can be reposted, increasing reach without necessarily increasing cost. At the same time, several participants highlighted that social media providers may treat commercial lenders more favourably in advertising and search rankings. They suggested that an agreed definition of social / community lending could facilitate differentiated treatment.

- A few participants stressed the importance of presentation and positioning in its dealings with customers and the risks of imparting too many message to consumers. Participants noted that people have complex and subjective reasons for making decisions. It was noted that relationships are very important which explained why people might choose to use high-cost credit providers over lower cost alternatives.

- Participants generally noted that advice bodies, housing associations etc. may be reluctant to signpost to alternative lenders, because of concern about transgressing the regulatory boundary into debt advice or credit brokerage. It was suggested that the FCA could provide clarity in this regard.

- A few participants said that credit unions can only market products to members so have to adopt a two-tier marketing strategy to grow (one to members for loan products, another to encourage new members). This can be costly.

Theme 6: further provision of essential goods by social housing providers can be encouraged by providing greater clarity about funding sources, a clear pathway to delivery and advocacy on the social benefits.

- Many participants called for greater clarity to be provided by government to housing associations, registered social landlords, local authorities and tenants on how benefits and grants can be deployed for acquisition of essential goods (whether on a temporary or permanent basis).

- Some participants called for closer working between government departments and local government to encourage and coordinate delivery of essential goods schemes by housing associations and registered social landlords as part of financial inclusion and social care programmes. One participant highlighted variation in the approaches of local authorities/local benefit offices that might indicate the need for further centralised coordination and clarity.

- There was support for the idea that the social benefits arising from the provision of essential goods needs to be better understood as part of an overall social and financial inclusion strategy. It was suggested that social landlords could be encouraged to consider delivery of their own schemes if they could see essential goods provision as part of a wider strategy to address financial and social issues such as rent arrears, abandoned tenancies and health concerns that may arise as a result of unfurnished properties for some tenants.

- A few participants suggested that there needs to be recognition that the brand of the essential good may play a powerful part in consumers' decision making even if this may seem illogical and be at increased cost to the tenant.

- There was widespread support for targeted guidance or a toolkit to assist those providing essential goods to tenants to understand what was needed to ensure compliance. It was suggested that such guidance could include worked examples or templates for certain models of provision and provide clarity over what activities constituted regulated activity to overcome potential barriers to effective partnership facilitation. There were also calls for related training for staff and tenants to build financial knowledge including on budget management, finances and digital.

- One participant noted that the social housing model often required tenants to make decisions and move quickly. It was suggested that the short-notice and lack of control has cost implications for tenants and may put the most vulnerable at risk. It was noted that some housing associations had taken steps to reduce the time pressure on prospective tenants such as a housing association which puts all shortlisted tenants through a 'preparing for your new home' training programme. This means that unsuccessful tenants will be ready and prepared when they are eventually selected for a home.

- Some participants noted that hard-pressed consumers may be acutely aware of money passing through their hands but have limited options on how this was deployed. There was anecdotal evidence of some tenants using their rental or utility account as a surrogate bank account though making overpayment. A few participants called for social housing providers to permit the flexing of payments to allow for income smoothing.

- One participant suggested a number of methods for reducing the cost of goods. Firstly, social housing providers could have bulk purchasing deals and could bulk negotiate essential goods. Secondly, social housing providers should be provided with greater clarity on regulations relating to recycled goods, such as Health and Safety legislation. This would assist with the creation of formal processes for delivery which may currently be limited or on an informal footing due to fears or lack of understanding of regulatory requirements. Thirdly, white goods as part of the rental offer could be provided as a float to allow tenants to 'find their feet' then be deployed to the next beneficiary.

- One participant highlighted that many tenants that are in receipt of benefits reside in private accommodation and should not be ignored when considering issues of access to essential goods.

Next steps

We welcome further comments on the issues and ideas raised by participants in our roundtables. You can send any comments to:

James Eldridge
High-cost credit review
Strategy and Competition Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone:

02070669280

Email:

highcostcreditcfi@fca.org.uk