Response to Call for Input:

High-cost credit, including review of the high-cost short-term credit price cap

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Introduction

In November 2016, the FCA issued a Call for Input to inform further work on high-cost credit, including a review of the high-cost short-term credit (HCSTC) price cap. Our responses below draw on evidence from a major study for the Arts and Humanities Research Council on *Responsible Lending and Borrowing for Low-income Consumers*[4]. Part of this study involved in-depth interviews with borrowers of payday lenders, doorstep lenders and credit unions. These interviews were conducted between March and May 2014, hence before the price cap was implemented in 2015. They cannot, therefore, shed light on the impact of the cap but they are informative in relation to the detriment caused by other forms of high-cost credit and so will be drawn on in this paper. Other parts of the research involved interviews with key stakeholders and analysis of relevant reforms in Australia[5] (including the introduction of a price cap on HCSTC). Further information and analysis from this study can be found in papers published in the *Journal of Social Policy*[6] and *Competition and Change*[7].

Our overall response to the work of the Financial Conduct Authority in this space is to commend it for the significant time and energy which has been devoted to improving the situation for consumers in the UK. Recent figures from the FCA outline that the use of payday lending and other forms of HCSTC has reduced significantly since the implementation of the cap on the cost of credit and other borrowing regulations. For example, there has been a 20% reduction in approval of loans of this type, an 8% fall in default rates, and 800,000 fewer people took out a loan over an 18-month period.[8] The regulations have not, however, solved the underlying need for credit, as unsecured debt is continuing to grow.[9] Financial exclusion and vulnerability remain significant – and in many ways growing – problems in the UK.[10] Poverty is still a huge problem, with the UK ranked 28th out of 34 OECD countries in terms of income inequality.[11] It is clear more can be done and we also refer the FCA to the forthcoming report of the House of Lords Select Committee on Financial Exclusion, due to be published in March 2017.[12]

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4 The project continued until June 2015.

5 Jodi Gardner and Karen Rowlingson (2014) Towards a 'cost of credit' cap in the UK: Lessons from Australia, CHASM Briefing Paper.

6 See Karen Rowlingson, Lindsey Appleyard and Jodi Gardner, 'Payday lending in the UK: the regul(aris)ation of a necessary evil?' (2016) 45 Journal of Social Policy 527.

7 See Lindsey Appleyard, Karen Rowlingson and Jodi Gardner, 'The variegated financialization of sub-prime credit markets' (2016) Competition & Change 20 (5) 297.

8 The Financial Conduct Authority, *Changes in payday lending since we took over consumer credit legislation* (The Financial Conduct Authority 2016).

9 Hilary Osborne, 'Rise in consumer borrowing is fastest since pre-crisis, says Bank of England' *The Guardian* (4 January 2017).

10 Charlie Cadywould, *Banking for All* (Demos, 2016) 15-17.

11 Caroline Slocock, Ruth Hayes and David Harker, *Whose Society? A Final Big Society Audit* (Civil Exchange and DHA, in conjunction with Joseph Rowntree Charitable Trust and the Barrow Cadbury Trust 2015) 57.

12 Lord Select Committee, Financial Exclusion Committee.

Section 1: High-cost credit

Question 1: Which high-cost products do you think our review should focus on and do you think a more consistent approach to high-cost products is feasible or desirable?

The fact that the current limitations only apply to particular loan products defined as 'High-Cost Short-Term Credit' (HCSTC) means that avoidance of the cap is possible, thus undermining the protection afforded to consumers. This can occur in a number of ways. For example, the cap does not extend to home-collected credit, which can provide loans of £70-£80 on £100 lent. It may also be the case that payday lenders have changed their business model so that the loans fulfil the definition of a 'home credit loan agreement'. Loans could also be structured so that they run over 12 months, thereby avoiding the cap altogether. Bank overdrafts, whether arranged or unauthorised, may also charge more than the proposed cap and thus be more expensive for consumers than traditional HCSTC products. Avoidance was certainly a feature of the response to the price cap in Australia, according to the interviews we undertook with key stakeholders there.

The main focus on high-cost credit is the expense of the financial product being offered, not the specific characteristics or structure of the loan. If the rate of these products is over the 100%APR limit, we struggle to understand why they have not been included in the relevant FCA regulation and restrictions. In our opinion, the exclusion of banking overdraft facilities and home-collected credit from the initial cap was unjustified.[13] This high level of interest is likely to cause financial detriment to consumers and thus should be covered by any cap. We therefore believe that serious consideration should be given to extending the cap to cover all forms of commercial credit including bank overdrafts and home-collected credit. We have discussed this in more detail in the questions below.

We do however note the one relevant exception to this is Community Development Finance Institutions (CDFIs), as these products are provided to financially excluded individuals on a not-for-profit basis. Occasionally – due to the financial risk of the individual being provided with credit – there is a need for CDFIs to provide loans of over 100%APR. These loans are however given to the individual in a responsible manner and in an attempt to avoid the borrower from becoming financially excluded or being forced to turn to other more expensive and potentially harmful credit. Thus the focus on FCA regulation should be on commercial providers of credit and the exception provided for CDFIs should continue.

Question 2: To what extent is there detriment from high-cost credit products (other than HCSTC)?

Our research shows that consumers can suffer financially from a range of high-cost credit products, and the harm is not limited to HCSTC. For example, home-collected credit can often be a more expensive, longer-term financial commitment than payday lending – which means many people get stuck in a home-collected credit 'debt cycle'. Home-collected credit also has a number of other concerning features, such as the personal nature of the lending and the potential for vulnerable borrowers to be 'targeted' by lenders. Our interviews with consumers also highlighted that people use a wide variety of financial products (something supported by the CMA's empirical work on the topic), thus restrictions on HCSTC may merely increase their use of other credit products.

As an example, Case Study 1 highlights the impact that home-collected credit can have on vulnerable borrowers who can easily get caught in a harmful debt spiral.

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[13] Karen Rowlingson, Lindsey Appleyard and Jodi Gardner 'Capping the cost of payday lending in the UK: What will the impact be?' Paper for the Financial Conduct Authority, July 2014.

Case Study 1 – Home-Collected Credit and Vulnerable Borrowers

Sasha was in her mid-30s and was an unemployed mother of three young children, one of whom had special needs. She showed a number of signs of being financially excluded. She had been made redundant in 2007 and claimed out-of-work benefits since then. She did not have a bank account and relied on her post office account and used cash for all expenses. Sasha currently had numerous loans with a doorstep lender working in her area. In addition, Sasha occasionally used another doorstep lender for one-off credit needs, such as taking her children on a holiday, but has had a steady stream of doorstep loans since 2005.

Sasha's use of doorstep credit started because a door-to-door salesman offered to take some professional pictures of her children for £250, but she did not have the funds at the time so needed to get a loan to pay for the photos. She was working part-time at that time, was not earning high wages, and she quickly being dependent on home-collected credit for her everyday expenses. As outlined by Sasha herself:

> *'once I'd paid that, then do you want another loan, and it's like well, I could buy this for the kids, I could buy that. It's like easy money, you have to pay it back but it's easy money when they're offering it you and you've got like two kids and single parent and then I was made redundant in 2007, so I had a newborn baby and my son and, you know, she offered me money which kind of helped out buying beds and, you know, things like that. So it's kind of easy money.'*

Almost 10 years after the initial loan, Sasha had become dependent on doorstep lending and was caught in a deep debt-spiral. When asked about how she felt about the loans, Sasha commented:

> *'Well, I'd rather not do that. I'd rather have my money and save my own money, like what I'm paying them a week save that and pay no interest, but we don't live in that kind of world. So obviously I don't want to pay an extra £300 for a £400 loan, but in times of need it's how we live, really, you know?'*

She used the most recent loan to buy new bikes for her children and was intending to buy a new dining table. Unfortunately when she went to purchase the table, it was no longer available so she bought something else though she said she couldn't remember what it was. When asked what she would have done if she did not have access to the doorstop credit, Sasha stated:

> *'I'd have probably tried to save the money and get them the bikes. It's just … it's easier when they offer you and say you can renew and you've got something in mind that, like I see them and thought oh, they're a good bike, I'm going to get the kids them for Easter, and then I'm not just buying them a bike for the sake of buying them a bike, I'm using Easter as an excuse. But I would have saved up and probably took me a bit longer to get them, but then she offered and said oh, that loan's finished, you can have another one and I'd already had the bikes in mind and I want a new dining room table … but I wasn't approaching her; she just said one of your loans is finished and I didn't even realise it had come to an end. You can renew that and I was like, oh, okay then. Because I'd already had stuff appear that I want … You know, you've always got stuff that I need to get this or … and when you've got a house and kids you've always got stuff that you want to buy and obviously they come and then they say this one's paid off, so I*

just keep renewing ones that are paid off.'

The case study is a clear example of a financial product creating its own demand as opposed to fulfilling a clear consumer need[14]. This is an aspect of payday lending, but is also evident in doorstop lending due to the relative ease of access. Sasha's needs are understandable (bikes for her children and a new dining table) but, as she said herself, she could have gone without these temporarily without particular detriment while she saved for them. This would have meant going without for a period of time but saving a considerable amount of money in terms of interest payments.

Question 3: Where there is detriment, do you consider that it arises from matters not addressed by our rules, or is it mainly caused by firms failing to comply with the rules?

We believe that there remain some gaps (or potential loopholes) in the rules to address HCSTC. These include the requirement for loans to be under 12 months in duration. It will be quite easy for firms to structure their loans so that they fall just over this timeline and thus are not covered by the cap. This will result in significant consumer detriment, as the borrower will be paying high levels of interest over a much longer period. Similar issues have already been raised above in relation to the longer-term home-collected credit products. Secondly, whilst there are restrictions on the number of times a loan can be rolled over, there are no limitations on the number of loans borrowers can obtain within a specified period. A failure to restrict the number of loans effectively renders the rollover limitation redundant, as people will be able to repay the existing loan and obtain a new one straight away. Other jurisdictions have addressed this issue in a variety of ways. For example, under the Australian Responsible Lending Guidelines borrowers will be presumed to be unsuitable for additional loans if (a) they are currently in default under a loan or (b) have had two or more loans in the past 90 days.[15]

As outlined by the 2012/2013 reviews by the Office of Fair Trading (OFT), lenders have a quite patchy history when it comes to compliance with rules on high-cost credit lending. The FCA have undertaken a significantly more proactive enforcement and supervision regime than the previous regulator. It is hoped that this will result in more firms complying with the relevant rules. It would however be extremely useful to have another compliance review on this topic. Understanding the extent to which firms are (or possibly are not) complying with the legislation will assist the FCA to truly determine the level of consumer detriment arising from the use of high-cost credit. Case Study 2 highlights that, in addition to a cap on the cost of credit, there is a strong need for a robust responsible lending regime that includes credit checks and due diligence during the application process.

Case Study 2 – Irresponsible Lending

Sarah was 28 and a single mum with two children who had recently started working in hospitality on a zero-hours contract. Within the last twelve months, Sarah had accessed high-cost credit from one online payday lender and one high-street payday lender even though she had been unemployed at that time. Sarah used her loans which totalled £440 '*just to get by'*, for her small children and for essentials such as *'food and electric and gas'*. Sarah did not mention any application for local welfare assistance. This might have

[14] See Sarah Beddows and Mick McAteer, *Payday lending: fixing a broken market* report (2014).

[15] For more details see Jodi Gardner, *The Challenges of Regulating High-Cost Short-Term Credit: A Comparison of UK and Australian Approaches* (2014), CHASM Case Study.

been an option though access to such schemes is extremely limited and difficult.

When Sarah applied and took out the payday loans she was not working and knew she would not be able to repay the loan. However, Sarah said she completed the application process because *'it was just getting offered to me and I needed it'*. So there appeared to be very few checks of her ability to repay.

Unsurprisingly then, Sarah had not repaid any of her payday loans from either of these lenders. She now believed, if she were to try to do so, she would have to repay a total of £900 for the two loans but this figure is likely to be significantly higher due to default charges and fees. If Sarah had been unable to access money from the payday lenders she said that she would have just '*struggled*' to live. Sarah is now employed although her work is not guaranteed and her income fluctuates significantly which makes it difficult to budget and plan ahead let alone plan to repay her debts.

If there had been effective credit checks and due diligence within the payday loan application process, it is unlikely that Sarah would have been able to access any high-cost credit from online or high-street payday lenders. This case study reminds us that the cost of credit is only one issue for regulators and that rigorous credit checks need to be in the loan application process so that people are able to prove that they have the means to repay their loans. The fact that Sarah did not pay the loans back will probably make it more difficult for her to access credit in the future.

A third issue that should be considered when looking at the causes of consumer detriment in the high-cost credit market is the lack of financial alternatives available to many borrowers. The findings of the AHRC project on responsible borrowing were published in the *Journal of Social Policy*, with the authors commenting that:

> We are not seeking to deny … that payday lending is an extremely expensive form of credit which can lead people into highly problematic debt situations. We do, however, argue that a more critical analysis of the root causes of the growth of payday lending, along with a better understanding of the 'lived reality' of payday borrowing provides an important basis for a robust analysis of policy options. We have shown that the regula(risa)tion of payday lending will do nothing to tackle the root causes of demand for this form of credit[16]

Whilst most users of high-cost credit may benefit from a more protective approach to regulating high-cost credit, some – usually those who are already the most vulnerable – could be worse off.[17] The Financial Conduct Authority has recently admitted that the regulatory amendments will result in 110,000 people no longer being able to access high-cost credit. The research does not explain what will happen to these individuals, but the regulator generally assumes that they will be 'better off' being unable to access the market.[18] Unfortunately this is not necessarily the case, and the inability to access high-cost credit can actually exacerbate the financial situation of vulnerable borrowers. A balance

[16] Rowlingson, Appleyard and Gardner (n 6).

[17] Ibid, 540.

[18] The Financial Conduct Authority, *Detailed rules for the price cap on high-cost short-term credit; Including feedback on CP14/10 and final rules* (2014). After the responsible lending amendments were brought in, the FCA readjusted its figures and stated that 70,000 people would be cut off from high-cost credit because of the price cap (The Financial Conduct Authority, *FCA confirms price cap rule for payday lenders* (2014); see also discussion in Rowlingson, Appleyard and Gardner (n 6) 539.

therefore needs to be struck between reducing access to sources of credit which cause detriment and enabling access to sources of credit which can be very helpful to smooth income and spending patterns.

Question 4: If there is detriment arising from matters not addressed by our rules, what sort of interventions should we consider? What would be the impact?

It is important for the FCA, and the government, to consider and address negative externalities associated with a tightening of restrictions on high-cost credit, particularly in terms of providing people with advice about alternatives. The Money Advice Service and money advice charities will need further support to deal with queries. When Australia introduced its cap in July 2013, there were a number of other measures in place to support people in financial difficulties, as well as providing access to short-term funds when needed. An example of a welfare-based approach can be seen in aspects of the Australian regulation of high-cost credit, where limitations on access to credit and interest rates were combined with programs to ensure that people excluded from the market would have access to affordable and appropriate credit if necessary.[19] For anyone who is wholly or partly reliant on government payments for income, the Australian welfare provider, Centrelink, has a variety of Advanced Payment Options. These allow benefit recipients to receive an interest free 'loan', which will then be repaid by a reduction in their future welfare payments. It is designed to ensure that the most financially vulnerable people have access to credit if an unexpected expense arises.[20] To be eligible for the program, the recipient must show that they can afford to repay the advance whilst still being able to cover their day-today expenses.[21]

Australia has also developed a No-Interest Loan Scheme and a Low Interest Loan Scheme (NILS/LILS). This program has allowed over 125,000 financially excluded Australian borrowers to access affordable credit in times of need. This program provides no-interest loans of up to $1,200AUD to people on low incomes for the purchase of essential household items. The NILS capital (i.e. the funds used to provide the loans) is 'circular community credit'. The repayment of one NILS loan provides funds for another, and 97% of all NILS loans are repaid in full by borrowers. Once the NILS loan has been repaid, it is a pathway to a StepUP low interest loan. These are loans of $3,000-$8,000AUD that are repaid, in a similar fashion to a bank loan, over a three-year period. They are designed to provide a low-interest product for people who are excluded from affordable and appropriate mainstream credit.[22] A 2013 review of the program found that people who use these products are one step closer to financial inclusion, and are less likely to borrow from high-cost lenders.[23]

Recognising that people can still get into financial difficulties, the Australian government also funded the development of the Financial Counselling Association. Financial counsellors provide free, confidential and qualified advice and assistance for people in financial difficulty, including information, support and

[19] For more details on this regime, see Gardner (n 15) and Jodi Gardner, Karen Rowlingson and Lindsey Appleyard, 'Responsible Borrowing and Lending' (International Conference on Trade, Business, Economics and Law, Oxford, 2-4 March 2015).

[20] See details at Centrelink, 'Advance Payment Options' (*Australian Government, Department of Human Services*, 2016). A similar program exists for people who are on a pension; Department of Social Services, 'Seniors: Pension Advance Payments' (*Australian Government*, 2016).

[21] Department of Human Services, 'Centrelink advance payment scheme' (*Victorian Government*, 2016).

[22] Michelle Crawford, *About Good Shepherd Microfinance* (Internal Information Briefing Emailed to Jodi Gardner on 16 December 2013 2013).

[23] The Centre for Social Impact, *A little help goes a long way: Measuring the impact of the StepUP Loan program* (The Centre for Social Impact 2013). Almost 75% of users also reported a positive change in their social outcome after using the StepUP loan program; p. 28.

advocacy.[24] One of the government initiatives to further address problem debt was the creation of the National Debt Hotline (which is run by the Financial Counselling Association). This hotline allows all Australians to call during business hours and be automatically connected with a financial counsellor.[25]

Thus we strongly recommend that the UK to consider similar approaches. These will be critical to ensure that people do not unfairly fall in between the cracks that have – and will continue to – emerge. Case Study 3 highlights the significant positive impact made by access to affordable and responsible credit products.

Case Study 3 – From High-Cost Credit to A Credit Union

Gemma was a single mother in her thirties with four children. She did not currently have any paid work. Gemma first borrowed from a doorstep lender when she was 18 years old, working part-time with two small children and had moved into her first home which needed furnishing:

> *'they only gave me a couple of hundred pound for my first loan and then after a few months they gave me £1,000 but it was £140 a month back and I couldn't afford it so I got into arrears and that's how I got bad credit'*

Gemma explained what happened when she was unable to repay her doorstep loan:

> *'if you miss a payment they bang your door, they don't leave you alone and then you feel like people know your business because they're always outside your house and stuff like that. And some of them can get quite nasty and stuff but I found the one that I had she was always knocking the door and she was really loud and she wouldn't stop ringing me'.*

Being unable to repay her loan and the practices of this doorstep loan agent had a significant impact on Gemma:

> *'It really made my life miserable, I was depressed that's why, I was crying and it was like, I felt bad I felt like £140 a month I was giving it's a lot of money, I was depressed and then it got to the stage where I thought these companies are just making money off vulnerable people'*

The doorstep loan repayments meant that Gemma could not afford sufficient food for her and her family. It was only by chance when a family member found out the situation Gemma was in that they repaid her debt for Gemma.

Gemma then found out about credit unions. Gemma believed that:

> *'Credit Unions are really, really efficient and really good and they're more understanding about people's needs, family's needs and they don't even hassle you'.*

Credit unions can also respond to people's needs quickly as in Gemma's experience:

> *'I phone them up and they give the money within the hour so it goes onto my card, you get your personal card with them and you can have it into your bank or on the cards and I always have it on my cards because if it's emergency and*

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[24] Financial Counselling Australia, 'About FCA' (2016).

[25] See details at Financial Counselling Australia, 'Press Release: New Services for People Struggling with Debt' (2016).

it's like desperate they can give it me within the hour and then all that happens is it comes out of the kid's child benefit … So it is good for people out there that haven't got much and there's an emergency situation'.

If Gemma had not been able to access credit from credit union, she would have:

> *'struggled and probably had to buy less shopping and stuff because I would have no choice, I would have had to get some kind of finance because, or try and save but it's hard to save when you've got children and they always need something'.*

This example highlights the need for access to affordable credit for those on a low income and the significant negative impact that high-cost doorstep lending can have on an individual and a household.

Question 5: Should some of the HCSTC protections be applied more widely? What would be the impact on the cost of or access to credit?

This question has been addressed above. We strongly believe that the current HCSTC protections, including the cap on the cost of credit, should be extended to cover all forms of high-cost credit. In light of the consumer detriment arising from loans of over 100%APR, we do not see sufficient justification for the current exemptions on home-collected credit, log-book loams and bank overdrafts.

Question 6: To what extent do you think overdrafts are a substitute, or alternative, for other high-cost credit products? & **Question 7: What do you think are the key issues the FCA should consider on arranged and unarranged overdrafts respectively? (answered together)**

It is clear that many users of high-cost credits consider overdrafts as a potential alternative to high-cost credit products. This creates a situation where people compare the costs of both products (if they are able to access) and weigh-up what is most beneficial in their circumstances (see Case Study 4 below). A subsequent outcome of this will be that the significant reduction in payday loans witnessed in the last 18-months is likely to result in an increase in the use of overdraft facilities from banks.

Case Study 4 – Payday Borrowing Less Expensive than Bank Charges

Amy was in her mid-20s and was a mother of a young child living with her partner, Howard. They had only recently moved in together after living with their parents. Despite her young age, Amy had taken out a wide variety of credit products including rent-to-buy loans, payday loans and home collected credit. She needed the credit for a range of things, including baby items and a replacement tumble dryer. She also, at one time, needed a loan to pay her rent due to delays with housing benefit:

> *'I was on housing benefits at the time and my landlady didn't want to wait for the claim to go in and we were getting harassed and I was pregnant, I wasn't very well and basically, just to get peace and quiet, I went and got a [loan] out.'*

Another loan was for the deposit and first months' rent for an apartment for her and Howard to move into. When asked what she would have done if she did not have access to payday lending for this expense, Amy commented:

> *'Do you know what? Even now I don't think I could have done it any other way. There was no-one else who could financially help because we exhausted all resources asking people … we didn't have enough because [money she obtained from other sources] was the majority of the deposit and we had to find the first month's rent.'*

Amy was also still paying most of these loans off, and it appeared that she would be doing so for quite a while. She also had one payday loan that was '*sitting at the bottom of a drawer'* in her house as she was '*too scared'* to find out how much was left owing on the loan and did not want to tell Howard about the money owing on this loan.

Despite these issues, Amy and Howard were trying to iron out the finances for the sake of their baby and wanted to provide a financially stable household going forward. Howard was paid on a weekly basis and their level of income could change on a month-to-month basis, depending on how much he earned from additional jobs and overtime:

> *'My bank has recently said to me – because they nearly got me with bank charges– because I got a bit confused with our finances over the bank holiday and I thought, 'Oh hang on. It's not going to come out,' and I got really scared. I was like, 'Oh no,' and rang the bank and said, 'Look. I think I'm going to get a bank charge, just remind me how much is the bank charge …' It's like £6 a day. I'm trying to work out is it cheaper to get a [payday loan] … or is it cheaper to have the bank loans. … yeah, I do panic a lot when it comes to that.'*

At the end of each month Amy and Howard sat down and worked out the family finances and whether they had enough funds for all their expenses. If they were unable to afford to repay all of their outstanding debts, they then checked to see if it would be cheaper to get a short-term payday loan to keep them going until Howard was paid next or whether it would be better to incur the bank charges associated with going into unplanned overdraft.

Amy and Howard, like many people today given the labour market, were struggling to manage on a low and irregular income. In these circumstances, payday lending, for them, was a helpful option and often a cheaper one than going into an overdraft situation. Delays with benefit payments and a lack of patience from their landlord contributed to their problems. If payday lending had not been available to them it is difficult to see that their situation would be much improved.

Question 8: What measures could be taken to address these and what would be the risks and benefits?

Whilst we are aware of the work being undertaken by the Competition & Markets Authority (CMA) on overdraft accounts, specifically fee structures, we do not believe that the current recommendations go far enough. Having different regimes – and charging structures – for different products is also likely to cause confusion with consumers. We suggest it would be better to draw overdraft facilities into the cap on the total cost of credit. This means when determining what type of product would be more beneficial for their financial situation, borrowers will have an easier time comparing their potential options.

There are some risks posed by this approach, namely that overdraft facilities will no longer be provided to people whom the bank classifies as too 'high-risk'. However, this may be a preferable outcome to the current situation where extortionate bank penalty fees mean that financially vulnerable customers may be subsidising the free banking of others.[26]

Section 2: HCSTC price cap review

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

- **the reasons for the substantial reduction in applications from consumers for HCSTC and the reduction in acceptance rates by firms**
- **whether this decline will continue, plateau, or lending will increase**
- **the impact of the price cap on the viability of HCSTC and how this might differ for online and high-street, and**
- **the impact on loan duration and product development more generally of the structure and level of the price cap**

Whilst it is clear that levels of HCSTC are decreasing, it is important for the FCA to gather further empirical research providing evidence of the consequences the current cap. From our research, we have identified the potential consequences include the possibility that people:

- find an alternative though similarly expensive forms of licensed credit, eg doorstep lenders, pawn brokers, rent-to-buy, logbook loans etc
- find alternative and possibly cheaper forms of credit, eg credit unions, local welfare/charitable assistance, mainstream banks
- find sources of money elsewhere, eg by selling something
- turn to illegal lenders
- turn to informal sources, eg family and friends
- go without certain goods/services which are either luxuries or, at least, non-essentials, and so do with relatively little harm
- go without certain goods/services which are essential (eg food, heating), and therefore cause more harm than good.

Some of these outcomes improve consumer's welfare, whereas others are significantly worse than the use of HCSTC products. In order to understand the prevalence of these different outcomes, it is necessary to have a detailed survey and case study evidence about why people use payday lenders and what they might do if this source of credit were not available to them. The recent CMA Report explored these issues to some extent and suggested that some customers would struggle to find alternative sources of licensed credit. For example, the report highlighted the fact that four out of 10 payday borrowers had no access to alternative financial products and therefore limited choice[27]; 51% had not used any other credit product in the last 12 months.[28] However, six out of ten borrowers had never 'shopped around' before entering into a payday loan[29], suggesting that some might have been able to find an alternative source of credit if this one had not been available to them. Or perhaps they already knew that there was no alternative and therefore no point in shopping around.

But what are borrowers using the loan for and what would the consequences be of doing without it? Six out of ten borrowers in the CMA survey said they spent the funds on something that they believe they

[26] For example, Lord Turner, chairman of the Financial Services Authority, called for an end to free-if-in-credit banking in 2012.

[27] Competition Commission, *Research into the payday lending market: Final report* (2014) 80-81.

[28] ibid, 27.

[29] ibid, 96.

definitely could not have gone without.[30] More than half of payday borrowers access the funds for living expenses, and this amount increases to 70% if car expenses and general shopping are included in the figure.[31] Using high-cost credit for these general expenses is potentially harmful, as people can easily become reliant on the funds to get by every month and get caught in a very expensive debt spiral. As an example, recent research from StepChange highlights that this debt spiral and the need to keep up with credit repayments can result in children missing out on necessities; in the last year nine out of ten parents in problem debt in their research needed to cut back on essential items for their children in order to repay debts.[32]

The CMA survey is extremely helpful in providing evidence on a large sample of payday customers but survey data is often quite broad-brush and the meaning of terms like 'living expenses' can include a wide range of items some of which are basic necessities while others may be less vital for people to have. Also, people might say that they could not go without certain items but, nevertheless, manage to do so without particularly negative consequences. Our case studies of borrowers help us to understand the complexities here to explore, in depth, why some people use payday lenders and what the consequences might be for them if this source of credit is unavailable. Further quantitative empirical research is however necessary and we encourage the FCA to consider work in this area.

Question 10. Do you have views and evidence on the risks for consumers of using HCSTC post-cap? Do you agree with our initial assessment that risks of falling into arrears have reduced? & Question 11: Do you have any evidence of adverse consequences for consumers as a result of being declined for HCSTC? (answered together)

The enhanced responsible lending guidelines and cap on the total cost of credit are likely to reduce the impact of people falling into arrears with their loans. We agree with the initial FCA assessment that this has reduced. However, our concern is the underlying assumption that a reduction in risk of falling into arrears is prima facie a good thing. If the risk has only decreased because a large number of people can no longer access any sort of commercial credit – and thus may be pushed into illegal credit, financial exclusion or other more expensive/harmful types of debt – the reduction in arrears is not a good thing. It is important for the FCA to look behind the statistics and understand the reasons why these actions are happening, not merely assume it is evidence of a healthy and working market.

One issue that we have not discussed in this paper is the concern that some people might turn to illegal lenders if they lack access to other forms of credit. Only one of our sample (of 44 people in total, using a range of different sources of credit, interviewed before the introduction of the cap) mentioned illegal lenders. The evidence from a range of other studies is very mixed with some suggesting that demand for illegal lending actually goes down when legal lending declines[33] while others suggest that illegal lending might substitute for legal lending[34]. The problem here is that it is extremely difficult to measure illegal lending given its criminal and underground nature. Measures to tackle illegal lending through local teams will be vital to keep on top of the potential for this form of credit to expand in the next few years.

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30 ibid, 68.

31 Ibid, 68.

32 For more information on the impact of problem debt on children and families, see StepChange Debt Charity, *Debt Trap: Exposing the Impact of Problem Debt on Children* (2014).

33 Damon Gibbons, *Taking on the money lenders: Lessons from Japan* (Centre for Responsible Centre, 2012).

34 See, for example, Consumer Finance Association, *Response to HMT/BIS Impact Assessment* (2013) and *Should UK payday loans costs be capped? International Comparisons* (2013); Policis, *The Effect of Interest Rate Controls in Other Countries* (2004).

Question 12: Do you agree that consumers do not generally move to other high-cost credit products as a result of being declined for HCSTC?

We note the FCA reported that within 30 days of individuals being declined a HCSTC application, between 8- 13% took out a new credit product. This appears to indicate that consumers do not generally move to other high-cost credit products. The extent of this research is not clear. It would be helpful to combine this information with an indication of whether consumers went into overdraft with their bank accounts, increased purchases on their credit cards and/or borrowed money from family or friends. As previously outlined, the CMA report highlighted that four out of 10 payday borrowers had no access to alternative financial products.[35] This indicates that a significant minority of these people may not have taken out a new credit product because they were completely excluded from the financial market, which could be worse on their overall wellbeing than the use of HCSTC.

Question 13: What are the implications for consumers of increasing loan duration for HCSTC?

It is often assumed that the 'payday' model of lending is more inherently detrimental for consumers than longer term products. Whilst this is often the case, particularly if the borrower is unable to repay the loan in full and on time, we do not agree with the general assumption that longer-term debt is necessarily more beneficial. Quite to the contrary, our research found that some people specifically choose a HCSTC product because they valued the ability to repay the debt quickly and wanted to avoid the longer term commitment that often came with home-collected loans or credit cards. Case Study 5 highlights that on occasion short-term debt is preferable to longer-term commitments and that lenders should have an obligation to provide consumers with the most suitable product for their needs.

Case Study 5 - High-cost instalment Loan More Expensive than a Payday Loan

Over the last five years, John had a number of loans from different payday lenders for car repairs and household bills when he was in insecure employment. If John was unable to access a payday loan he could have asked family to help, however John preferred to handle the situation himself:

I didn't want to bother them (my family) by asking for the money, because obviously they'll start asking questions and worrying. I'm better off just sorting it myself.'

John had also used home-collected credit once before but did not like the protracted repayment period or the agent calling at home. John preferred the quick one-month repayment requirement as '*I'd rather just get it out of the way'.* John thought that this would be better because *'at least it's not on my mind then. I do worry a bit and I'm like, 'Oh, I've got that [doorstop lender] to pay again this week.'*

Our concern is therefore not specifically with the loan duration, but with ensuring that people are given appropriate advice and lending occurs in conjunction with robust and suitable responsible lending guidelines. The key should be focused on ensuring that all borrowers can repay their obligations on time, in full and without financial hardship.

Question 14: Do you have views or evidence that the HCSTC price cap has had an impact on other high-cost products: e.g. because consumers use those products as an alternative?

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35 Competition Commission, *Research into the payday lending market: Final report* (2014) 80-81.

Our research occurred before the implementation of the HCSTC price cap, so we cannot make specific comments on the impact it may have had on consumer behaviour. Our research does however show that: (a) The majority of people used multiple kinds of financial products, including mainstream bank overdrafts, HCSTC, home-collected credit and credit cards together and (b) if people were unable to access HCSTC, many would turn to other – potentially more harmful – financial products.[36] This appears to be bearing out in the financial landscape post HCSTC price cap. The regulation has clearly not solved the underlying need for credit, as unsecured debt is continuing to grow at significant rates.[37]

Question 15: Do you have evidence that the definition of HCSTC is providing opportunities for firms to evade the HCSTC price cap (and HCSTC regime more generally)?

This has been discussed in Question 3 above.

<u>Section 3: HCSTC repeat and multiple borrowing</u>

Question 16: What are your views on our analysis of the data and market with regard to repeat and multiple borrowing? Question 17: Do you have any further evidence on repeat and multiple borrowing? (answered together)

The analysis of the data provided by the FCA is in line with other information available on repeat and multiple borrowing. There is however an ongoing concern that people can start out borrowing HCSTC and repay on time, however it may become an increasing financial burden until they can no longer repay without hardship. Case Study 6 is an example of a situation where a repeat borrower – who started off being able to repay easily – got into financial difficulties.

Case Study 6 – Repeat Use of Payday Loans

Carl was also in his mid 20s, single, working full-time and living with his parents. Carl used a payday lender on three occasions over a period of nine months. Carl said that he borrowed the money to go out with friends at the weekend and to bridge the gap between pay days:

> *'the first two times was a night out, so [I was] sitting at home at ten o'clock, all my mates were out, couldn't get the money so I thought, that's how I initially got into it because I really wanted to go out and I needed the money so that's how I initially started using the pay day sites. First few times was probably underneath £100 each time and then the last time I used it, it was £150 and that was because I need[ed it] to last about a week until I got paid'.*

Carl admitted that he didn't shop around for the 'best deal' as easy access was key to this type of lending:

> *'To be honest well no but I mean that's the whole point of the sites isn't it? It's money that you need straight away and if you need it desperately then you're going to pay what you need to'.*

Carl said that if he hadn't been able to access a payday loan he *'probably wouldn't have*

36 See specifically findings released in Rowlingson, Appleyard and Gardner (n 6).

37 Osborne (n 9).

gone out'. So initially Carl felt that he didn't necessarily need the money and thought that he would be able to repay at his next payday:

> *'I think the thing was, the way I see life it's about memories, it's about going out having fun, I knew I'd have the money to pay them back and I knew that the interest, fair enough I don't want to pay it but I knew that I had that money accessible in my account. So I, yeah like I knew I could pay it off, I knew it weren't going to be a big deal'.*

However, Carl then started to borrow for more general expenses and then found repayments a struggle. When his parents discovered this they repaid the debt for him so he wouldn't incur default charges:

> *'I had about ten days until pay day and I borrowed £150 and I think they quoted me sort of about £37/£40 interest so, but obviously if you pay it late you have a £30 late fee and things like that. But I ended up, my mum and dad found out I did it when I got back which was about five days before I had to pay it back and they made me ring up and pay it off with their card just to save me a bit of money'.*

Carl felt embarrassed asking for financial help from his parents to repay the loan early for him. However, if Carl's parents had not have the loan for him he would have been unable to repay and incurred additional fees and charges. This example shows the trajectory from optimistically taking on a payday loan to dependence on accessing high-cost credit. It also reflects the broader impact on household finances and reliance on intergenerational financial support.

In Carl's case, lack of access to a payday loan might have meant that he did not go on a night out with his friends. This would not have caused major harm but he would have missed out on social activities that were important to him and given that he understood the cost of the loan and could afford it, he made the choice to spend his money in this way. However, the fact that his parents subsequently helped him out with a loan to avoid default fees suggests that his borrowing had become more problematic and the initial unproblematic loan had led to a more difficult situation.

It is interesting to note that in Carl's case, he would probably not have been flagged by the FCA as an issue. Because he never officially went into arrears (due to the intervention form his parents), the lending would not have appeared to cause him any difficulties. This highlights the importance of qualitative empirical research (in conjunction with quantitative work), to fully appreciate the lived experience of borrowers and the impact that lending has on their lives and financial wellbeing.

Conclusion

Our case studies, alongside evidence from the CMA survey and other recent research, highlight that the reduction in access to HCSTC has led to some people finding alternative, though similarly expensive, forms of licensed credit, eg doorstep lenders, pawn brokers, overdrafts, rent-to-own shops etc. Given the high cost of these alternative sources, any potential reduction in consumer detriment from reforms to HCSTC will therefore be limited unless similar reforms, including a price cap, are applied more generally.

If a price cap was applied more generally, some people might find, and positively benefit from, alternative and possibly cheaper forms of credit, eg credit unions, local welfare/charitable assistance, mainstream bank loans. However, mainstream banks rarely offer the kind of loans that HCSTC customers are looking for (ie small loans) and it is becoming increasingly difficult to access local welfare assistance following reforms of the social fund and cuts in local authority budgets. Credit unions and CDFIs could provide a very beneficial alternative but have a very low profile at the moment and, in any case, would be unable to meet the potential demand from payday lending customers, without further financial support and advertising to raise the profile.

Some people who currently use high cost credit might find money elsewhere, for example by selling items. If this is something of particular personal value or need then this may not be beneficial but if it is an item they can easily do without then this could be a positive alternative. Some people might turn to informal sources for money, eg family and friends. This option is not available to everyone and often comes at an emotional cost of feeling shame for needing help. Financially, however, it could be a positive outcome.

If an alternative source of finance cannot be found then people may have to go without certain goods/services. Where these are either luxuries or, at least, non-essentials then this will do relatively little harm and, again, the financial benefit of saving interest charges and fees could be substantial but where people have to go without certain goods/services which are essential (eg food, heating) this could do considerable harm.

This is clearly a complex issue. Overall, we support the extension of the cap to other forms of credit, for example home-collected credit, log-book loans and bank overdrafts. This will help address the harm caused to borrowers by all forms of high-cost credit. It is important to note, however, that the complexities of the issues discussed above are likely to be magnified by the extension of the current cap on other financial products. The level of the cap should not therefore be such as to severely restrict access to credit where it can serve a positive purpose. And much greater consideration/support should be given to the role of advice services, credit unions and local welfare assistance to help those who might find themselves in need of help as a result of any reforms (including any extension of the cap). This goes beyond the specific remit of the FCA, of course, but the FCA should liaise with other agencies given the inter-linkages between credit and other aspects of people's lives.

Further information

CHASM, the Centre on Household Assets and Savings Management at the University of Birmingham, has recently been funded by the Arts and Humanities Research Council to carry out further work on responsible lending. As part of this, two key Australian stakeholders will be visiting the UK in May 2017 to share their expertise in this field. These stakeholders are: Adam Mooney, CEO of Good Shepherd Microfinance and Gerard Brody, CEO of the Consumer Action Law Centre. Adam and Gerard are leading experts in recent reforms in Australia around responsible lending including price caps and microfinance. The scheduled week for the visit is w/c 22nd May with an event planned in London on 24th May. We would be happy to invite members of the FCA to meet with Adam and Gerard to share their expertise at this event or arrange a direct meeting if this would be considered helpful.