How can we increase responsible lending and borrowing?
Tuesday 28th April 2015
Wellcome Collection, London

Panel session 1: What impact have recent reforms of high cost, short term credit had on levels of responsible lending and borrowing? What should be a priority for action here?

Russell Hamblin-Boone – CFA
Russell suggested that the High-Cost, Short-Term Credit (HCSTC) and specifically payday lending market has been transformed by recent FCA reforms. CFA members have been 'hit hard' by the regulation introduced in April 2014 and the cap on the cost of credit from January 2015. As a result of these changes, he suggested that the number of approved applications for credit has significantly reduced and many firms have withdrawn from the payday lending market. He went on to argue that the FCA review into collections and forbearance demonstrates sector reform whereby consumer interests are being considered over profit. Russell suggested that this indicated that the sector is undergoing a significant cultural shift. Russell argued that the FCA's mission to change cultures was highly unusual by international comparative standards. And he posed the question to the workshop about 'what 'good' might look like in terms of practice here?'

Peter Tutton – Stepchange
Peter thought that payday lending acted as 'poster boy' for the previous regulatory regime whereby the lighter touch approach had failed to protect consumers from harm and over-indebtedness. Peter thought that demand for lending needed to be reduced. Also, people need to seek support earlier rather than seeking credit to resolve their financial difficulties. Peter thought it was too early to say what the impact of HCSTC reforms were for example as people still have multiple payday loans and new HCSTC products are emerging which may be just as harmful. However, he did feel that the worst practice was on the decline. Peter suggested that there are ongoing issues with mainstream credit products such as the cost of overdrafts and the FCA needs to address this quickly. Peter said that it was important to consider the drivers of demand for credit: perhaps this is inadequacy of income or intrusion of the benefit system which may mean that it is easier to access HCSTC. Peter suggested that there needs to be better support for those in financial difficulties such as temporary reprieve from interest and payments. Peter pointed out that, among a recent sample of

Stepchange customers, more people had turned to food banks than credit unions, and there had been an increase in ‘distress credit’. Finally, Peter believed that savings could potentially help people avoid taking on credit, especially HCSTC even if when they have used up their savings. Ways of supporting people to save therefore need to be developed.

Mick McAteer – Financial Inclusion Centre
Mick suggested that payday lending was predatory and could not be justified as the business model relies on consumer detriment. He argued that payday lenders were not an unintended consequence of labour market change but that these lenders were consciously exploiting these changes. Mick believed that the regulation reforms have had a positive impact whereas previous reforms were permissive and flawed in that the regulation was framed around consumer empowerment. Mick asked how can we provide socially useful credit? Mick believed that mainstream banks are not breaking even on their core products so bank charges for being overdrawn (and being in financial difficulty) were high to subsidise so-called ‘free’ banking. For fair social policy, Mick believed that banking needed to be paid for. Mick believed that banks fail to provide for the financial excluded and those that do not receive regular payment such as those in self-employment so greater flexibility is needed. Mick suggested that there is space for alternative lenders to take advantage of the need for flexibility and community lenders such as credit unions and Community Development Finance Institutions (CDFIs) should innovate a diverse range of products and services. Although Mick acknowledged the challenges facing alternative financial providers in providing access to such products due to a lack of skills, capacity and economies of scale within the sector he did argue that this could be addressed through greater partnerships with housing associations, employers and so on.

Matt Bland – ABCUL
Matt believed that the price cap on HCSTC was a step in the right direction as evidenced by the redress of Wonga to customers that were unable to repay their loans due to poor affordability checks. But he also argued that regulators need to now consider other forms of high-cost credit including logbook loans, credit cards, rent to own and home collected credit. Matt believed that credit unions can provide alternative financial services. However, there would be risks to regulating them in the same way as other forms of credit as this would restrict the growth of the sector and its sustainability. Matt argued that credit unions need to be self-sustaining as government subsidies no longer exist and can distort business models. In the future, credit unions would need to work together to provide better products and services. He argued that these more competitive products and services will help to attract a more diverse membership to support credit union sustainability. Matt said that savings are an important to avoid indebtedness and credit unions play a key role in promoting saving for example through employer payroll deduction schemes which help to secure individuals and credit unions financial security – these should be extended.

Discussion: key issues

- Payday loan practises are in the process of being reformed. However, payday loans will never be the cheapest option due to the bureaucracy of the loan process.
- People borrowing multiple loans at the same time can be checked through new real time data sharing but sequential borrowing is also an issue.
- Need to think beyond payday lending when thinking about high-cost, short-term credit such as doorstep lending. The payday lending price cap is significant but other reforms may be better for borrowers.
- It will be very difficult to evaluate the impacts of recent reforms because there have been a number of changes over the last two years and it will be impossible to know which changes have caused any particular outcomes.
- There seems to have been a drop in home collected credit lending as well as payday lending and home collected credit was not subject to the price cap so must be other aspects of reform responsible for this (eg affordability checks or rollover limits?).
- HCSTC reforms shows that policy can be changed if strong evidence.
- Affordable credit is not always available from credit unions.
- The alternative finance sector needs to be more innovative in terms of diversifying its products and services to become sustainable so it needs to move beyond grant funding.
- FCA reforms are also having an impact on CDFIs as compliance is costly and this is delaying work on new product development.
- Some credit unions are innovating and, for example, offering payday loan products which act as a mechanism to draw in new customers to credit unions.
- Can commercial lenders also be socially responsible?
- How do we get credit to those that need it and how do we reduce distress credit?
- The Social Fund needs to be enhanced to serve the financially excluded rather than commercial credit serving this market.
- Financial education is not as effective as hoped but is nevertheless important
- What will the impact of a reduction in borrowing have on the economy more broadly?
- Savings are key to changing attitude to credit.

Panel session 2: What about the responsibilities of mainstream financial services and the welfare state (in terms of local welfare assistance for example)?

Damon Gibbons – Centre for Responsible Credit

Damon questioned the role of the state and lenders but also the role of the broader financial services system in promoting responsible lending and borrowing. There has been a shift away from the welfare state to a financialised system which has had a regressive effect on the poorest in society and wealth inequality. Damon suggested we should campaign for a progressive welfare system as the current financial system creates inequality, for example, through higher bank charges for the poorest and the lower rates of interest on low levels of saving. Regulators need to address free in-credit banking, credit cards, affordable credit. Damon suggested that there should be a more progressive financial system, with cross-subsidy from rich to poor rather than from poor to rich. Damon added that the alternative finance sector had insufficient scale in the UK and there needed to be a level playing field for credit unions and CDFIs as credit unions are subject to a price cap whereas CDFIs are not.

Ian Fiddeman – BBA

Ian highlighted that Mainstream Banks have been following a responsible lending code for a considerable period of time (The Lending Code where compliance of subscribers is monitored by the Lending Standards Board). This predates the recent FCA regulation.
Ian stated that regulation has been important to bring <u>all</u> of the industry into alignment as responsible lenders. However further over regulation of how this is achieved might stifle products and services offered. Mainstream Bank offering for short term cash borrowing requirements is typically by overdraft or credit card, and there are products to help new to credit segment. Some Banks do signpost customers to Credit Unions or CDFI's if customers do not meet their criteria as cheaper alternative finance providers. Ian added that consumers need to be better informed and more financially aware. Education can help to shape behaviour to build savings and financial resilience. It will also help understand the most appropriate and cost effective credit products and costs. Banks provide free Basic Bank Account to consumers and particularly low income earners; fund the bulk of the Government Money Advice Service costs each year (c£80m total MAS costs) and use analytics to pro-actively identify and nudge customers who might be heading towards financial difficulty to seek debt advice. Ian mentioned recent research that has shown for the majority of people taking out a payday loan, more debt was not the solution.

Pamela Meadows – Financial Services Consumer Panel (FSCP)

Pam commented that the most important recent change in consumer credit regulation has been the willingness to actively enforce pre-existing legislation (by the FCA). Pam provided evidence to demonstrate that there is a mass market for unsecured (and secured) credit in the UK. Pam believed that payday loans can be a useful product (especially for those without access to other forms of emergency credit such as a credit card) and added that profiting from consumer detriment is not a good or appropriate practice as business models based on default were both unsustainable and unethical. But Pam suggested that lessons could be learnt from payday lending – not least in terms of the use of new technology. Pam noted that credit cards were much more widely used than payday loans. Pam said that it was unprofitable for banks to lend small amounts for short periods so we need to find systems that serve everyone appropriately. She added that credit unions do not necessarily serve everyone's needs and they were not established to do so as sustainability is key. There remains is a gap in the market for small amounts of credit. Pam believed that affordability assessments should always have been commonplace within financial services but now that they are being enforced they could be more important than other reforms to the HCSTC sector. Pam mentioned an FSCP paper on cross-subsidisation and the CMA review of current accounts as useful material to add to the discussion.

James Plunkett – Citizens Advice Bureau

James reported that the CAB is seeing more issues at the moment with arrears especially in rent, council tax and priority debts (and fewer issues than before with credit cards and mainstream financial products). James also commented that the state is a more aggressive creditor than the mainstream finance sector. James agreed that we need to look beyond payday loans to other forms of HCSTC such as logbook loans (with legislation going back to the 1878 Bills of Sale Act) and guarantor loans, which might increase following reforms of HCSTC. James pointed to demand side issues and reported that there is a generational divide in the use of credit with younger people (under 35) using HCSTC and those aged 35 and above using more mainstream forms. He questioned how we might stop a generation becoming over-indebted? Is it a temporary feature, a cyclical issue or will it become a long term trend? James suggested there had been a shift from mainstream to HCSTC use and it was important for banks to consider how they treat customers that are refused finance and the impact that may have long term. James flagged up new Citizens Advice research on this issue to be published soon.

Discussion: key issues

- Mainstream banks lower value lending is typically on revolving credit. The economics of low value and high volume cash loan transaction costs make them less attractive or highly priced. Banks consumer finance divisions do provide credit for purchase of goods at retailers.
- Alternative financial institutions, such as credit unions, rely on investment and support from banks. Partnerships are key to sustainability. Banks need to demonstrate that they are working with the financially excluded otherwise a US-style CRA needs to be implemented.
- Over regulation can stifle innovation for financial services (including HCSTC, alternative and mainstream finance).

- The FCA can only regulate market products and so Social Policy, more broadly, is not within the FCA's remit but needs to be due to financial exclusion mandate to ensure than everyone has access to a bank account.
- Money advice is different to financial education e.g. budgeting over which loan is most appropriate.
- Is targeting supply (through regulation) more effective than targeting demand (through incomes/attitudes)?
- Credit Unions are currently great for planned borrowing, and for middle class savers/employees but are not necessarily able to meet the need for emergency credit whereas payday loans can. Need to change awareness and participation.
- Insecurity of income/jobs and welfare sanctions are very important, particularly self-employment.
- People need practical help using models like 'weight watchers' programmes.
- Regulation is not a cost to finance industry if it creates better products and makes organisations do things they should be doing anyway.
- A number of Banks support Credit Unions either bespoke funding of CU's or general community funding. Lloyds bank has invested in credit unions and financial inclusion is in the CEO's plan. It also has mandatory staff training in customer treatment and is investing in digital technology.
- Universal credit on the horizon is an issue.
- Banks are commercial organisations and investors expect a return. Current returns on equity are under pressure and balance between commerciality and social responsibility can create tensions.
- One option for the future would be a Community Reinvestment Act in the UK which could mandate the market to support people who are excluded.

Responsible lending and borrowing: overarching issues from workshop

From the discussion at the workshop, the overarching issue was around the responsibility of the lenders and regulator (FCA) to ensure that borrowers had access to appropriate and 'responsible' forms of credit that were affordable and could be repaid without consumer harm. A number of other issues also emerged which we plan to address in our project outputs or in future research:

- What is the role of regulation in protecting borrowers?
- What are the impacts of the HCSTC reforms?
- What is the role of mainstream financial services in providing appropriate/affordable products and services for everyone, especially the financially excluded?
- What is the potential for new players into this segment of the market? There is plenty of competition coming into SME and mainstream banking. How are alternative funders – e.g. home credit fulfilling the gap. They have been excluded from the payday lending definition as part of the CMA review.

- What is the role of the welfare state in supporting the alternative finance sector and those on the lowest incomes for a positive impact?
- What is the role of the consumer in ensuring responsible borrowing: Financial education and support? Access to alternative finance? Building savings?

If you have any comments on this event, please contact Lindsey Appleyard l.j.appleyard@bham.ac.uk