Financial Inclusion Commission Call for Evidence

Response from the Consumer Finance Association

Introduction

The Consumer Finance Association (CFA) is the principal trade association representing short-term (or 'payday') lending businesses operating in the UK. The CFA is pleased to have the opportunity to respond to the call for evidence from the Financial Inclusion Commission.

General Comments

A regulatory framework and supervisory approach that allows banks, building societies, credit unions and short-term lenders to serve a wide range of consumers is essential to increase levels of financial inclusion. As a first step, the regulator should be required to consider the impact on those consumers who will no longer be able to access products or services as a result of regulatory changes

More focus is needed on encouraging saving. Saving even small amounts on a regular basis can have a significant impact on the financial position of individuals and households, helping to provide a buffer to protect against financial shocks.

There is no one size fits all approach. Measures that help to tackle the financial exclusion of a group of people may not work for another group. Measures to improve financial inclusion should start from the point of assessing need in a particular group or groups and any resulting measures should be targeted at those groups.

Innovations in the market, new products and the use of new technology can be beneficial for consumers. There is often suspicion about new products, which initially at least fall outside mainstream financial services, but the use of new technology, new products and new methods of working can help tackle financial exclusion. However, it is important not to rely entirely on technology (as discussed above there is no one size fits all solution). Consideration should also be given to the position of those who, for whatever reason, can't or won't use technology. So there will be a continued need for high street provision to cater for a broad a range of customers.

Short-term lenders have led the way in assessing affordability and sharing information about consumers. Banks and other mainstream financial institutions need to follow suit and share information in the same way. Ensuring that financial institutions have a more complete picture of an individual or household's finances helps to tackle financial exclusion by ensuring decisions by financial institutions are based on facts as opposed to assumptions.

Similarly more positive credit reporting, for example rent payments, would help ensure that creditors were able to base decisions on complete data and consumers are rewarded for making payments on time.

A recent report by Respublica *'Climbing the Credit Ladder: Short-term loans as a path to long-term credit'* sets out the concept of a credit ladder idea as way of tackling financial exclusion. A credit

ladder would enable credit enhancement and help consumers to move between different forms of credit. To date the vast majority of the proposals to tackle financial exclusion have started from the point of forcing banks and other mainstream financial institutions to offer certain products. A more holistic approach is needed in order to achieve results.

The single measure that would best help tackle financial exclusion would be a requirement for the Financial Conduct Authority (FCA) to consider the position of those who will be excluded from some element of financial services as a result of the regulatory approach of the FCA. The main focus currently is on preventing or reducing harm to consumers from accessing the 'wrong' product with little attention paid to the harm caused by not being able to access that product, or in some cases being unable to access any products at all.

Responses to relevant evidence questions, on which the CFA has a view, are set out below

Evidence questions

What policy change would most support increased financial inclusion for the client group you represent?

The majority of short-term loan customers are mainstream customers. The short-term lending sector is an important part of the overall credit market, servicing customers who are no longer served by other financial institutions. Analysis by the Competition and Markets Authority (CMA) showed that short-term loan customers are more likely to be in work than the population as a whole. In terms of income, while 36% of payday lending customers were classed as having a low income (less than £18,000 per year), almost three in ten (28%) had a relatively high income (£36,000 or more per year)[1]. Policymakers and regulators need to recognise that short-term loans have become a mainstream product serving a mainstream market.

Ever increasing intervention by regulators is denying short-term loan customers reasonable access to credit. The FCA's own analysis, in Policy Statement (PS) 14/16[2], predicts that the supply of high-cost short-term credit will reduce by around 50% as a result of FCA regulatory changes, including the introduction of a price cap in January 2015. Regulators should consider the impact this reduction in the supply of credit will have on consumers' right across the spectrum of incomes and occupations. To date, the focus has been largely on protecting the perceived short-term loan customers, which is a stereotype created by the media and campaigners of peoplewho are on benefits or in a desperate financial situation with no other options.

There also needs to be some recognition by policymakers and regulators that not all consumers have traditional lifestyles. The days of everyone being paid the same amount at the same time every month are long gone. Many people, such as those on zero hours contracts, self-employed people and those whose earnings are based on commission, have erratic and unpredictable finances and have financial needs which often cannot be met by mainstream financial services institutions or products. For example many banks refuse to provide a small sum loan for a short period of time or offer a more expensive alternative, which does not meet the needs of consumers , such as a packaged bank account with a two year contract.

[1] https://assets.digital.cabinet-office.gov.uk/media/5329df8aed915d0e5d000339/140131_payday_lending_tns_survey_report_.pdf
[2] http://www.fca.org.uk/news/ps14-16-detailed-rules-on-the-price-cap-on-high-cost-short-term-credit

Customers need flexibility, both in terms of financial services products and in the ability of financial services providers to deal with changing circumstances and needs of their customers. The flexibility that firms can offer is dictated largely by the regulatory framework and the attitude of the regulator in supervising those firms.

Examples of the reasons why individuals and households need flexibility are illustrated by some verbatim quotes from customers to customer services teams below

- *'Funds will made available at some point today to cover my missed payment. There was an (sic) payment error from my employer which left insufficient funds in my account to cover my payment to you. I can get proof of this error from my employer should you require it. The matter should be resolved today'*
- *'My pay date has changed to 28th of each month so no funds will be available on the 25th to make my minimum deferment payment. I have tried to change this online but am unable to do so. Please can you amend the collection date to the 28th so that I don't receive a missed payment charge'*
- *'i must apologies for late payment on my account with above email address my wages were not in my bank account on last day of the month the boss didnot process them until the next day can you please apply to my bank again for the amount due of 75.73 and disregard the late fee as this was not my fault with late wages i would appreciate your cooperation in this matter and ask you aqpply for the next pay,ment on 1st of the month incase this happens (sic)'*

<u>What do you see as the role of the regulator, government, and financial services in promoting inclusion?</u>

Regulators and policy makers need to take account of the impact on those who will be excluded as a result of regulatory change, as well as the protection given to those who can continue to access products and services. Too little attention is paid to the issue of where those consumers who are excluded as a result of regulatory change can and will go for alternatives when they can no longer access a particular type of product. For example, the FCA work on a price cap for high-cost short-term credit did not consider the harm consumers may suffer if they were unable to obtain a loan.

A joined up approach is essential. The legislative framework needs to ensure that regulators take account of those who might be financially excluded, regulators need to consider the risk of financial exclusion for increasing numbers of customers and regulate in a way that allows financial services firms to serve these customers and offer flexibility when necessary and appropriate. This will only happen if there is a clear duty on regulators to consider the impact on customers who might be excluded as a result of regulatory change.

Being unable to access credit can have a negative impact on both individuals and households. A major study of people whose payday loan applications were turned down under new rules for lenders revealed that only a quarter (27 per cent) were better off than they would have been if they had been able to get credit from a short-term lender.

In the survey, conducted in August and September this year, 45 per cent of people said that they incurred a bank overdraft fee and 51 per cent incurred charges for late or missed payments on credit cards, utility bills and rent.

Worryingly, a third (33 per cent) considered using an illegal or unlicensed lender when they were declined. And, 4 per cent of declined applicants actually turned to an illegal lender, compared to just 2 per cent who opted for a loan from a credit union.[3]

The Government will need to manage the conflict between protecting vulnerable consumers and overregulation that restricts access to the creditworthy and has a negative impact on the UK economy. As the FCA ventures into consumer credit for the first time, some mistakes can be expected. The FCA has a mandate to protect consumers and, on the heels of the global credit meltdown and various mis-selling scandals, it is obvious that the FCA will make consumer protection a central focus. While it is clear from past events that financial services businesses require robust regulation to protect consumers, recent events also show that regulatory overreach can also cause unwanted effects. For example, it has recently been revealed that new FCA regulation on mortgage lending has resulted in qualified applicants being declined for mortgage applications at an unacceptable rate based on age, for example:

> ***'Home buyers over the age of 40 are increasingly being "frozen out" of mortgages , the industry is warning[4].***
>
> *New rules mean that lenders are now restricting loans to anyone who will still be paying off their mortgage by the time they retire.*
>
> *And yet many people cannot afford to buy a home until they are 40 or even 50, say some of the largest lenders.*

The FCA has acknowledged the problem but has placed responsibility for the issue on lenders:

> *'… the regulator is already on the case, judging by recent comments from Linda Woodall, director of mortgages and consumer lending at the FCA.*
>
> *She told a Council of Mortgage Lenders (CML) conference the City watchdog would be taking a closer look at lending policies, suggesting that some firms were applying the rules too rigidly'*

While it is possible that mortgage lenders have adopted a conservative approach to lending to older borrowers, this would be understandable in light of the FCA's aggressive rhetoric and enforcement posture in 2014. The FCA has taken a public stance that it will supervise and enforce rule violations aggressively and has backed this rhetoric with action:

> ***"Financial Conduct Authority hopes £1.5bn in fines will change behaviour[5]"***

The FCA needs to remain cognizant that firms will interpret new regulations and adapt behaviour in conservative ways to reduce regulatory and enforcement risks. Regulation and supervision must strike a balance that ensures both consumer protection and access to credit to worthy applicants.

The FCA was satisfied with its final HCSTC regulations and rate cap effects that will reduce access to HCSTC by 50 per cent, as predicted by PS 14/16. It is significant to note, however, that the initial FCA impact assessment for HCSTC regulations and rate cap effects was only 16% in the consultation

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[3] Research conducted by YouGov on behalf of the Consumer Finance Association http://www.cfa-uk.co.uk/media-centre/press-releases/current-press-releases/out-of-credit-survey-reveals-cost-for-borrowers-who-are-denied-credit-under-new-lending-rules.html

[4] http://www.bbc.com/news/business-30175365

[5] http://hereisthecity.com/en-gb/2014/11/23/financial-conduct-authority-hopes-15bn-in-fines-will-change-beha/

paper CP14/10. This shows that the FCA underestimated the impact of regulation by 34%. Coupled with the unexpected impact of the FCA mortgage affordability rules, this does suggest a pattern of unintended consequences. Over-regulation of payday lending may be unlamented by the general public and Government policymakers, with little pressure on the FCA to change approach. But unintended consequences caused by overreach in the regulation of mortgages and credit cards will be an unwelcome development both for increasing numbers of creditworthy consumers and the UK economy.

What opportunities are there to use technology to facilitate financial inclusion?

Short-term lenders have shown how technology can be utilised to facilitate financial inclusion, both by offering simple products online to customers who may otherwise be at risk of financial exclusion, and by leading the way in data sharing to ensure that lenders have the most up-to-date picture of their customers' financial circumstances.

Short-term loans are an excellent example of a simple product. Consumers borrow a relatively small amount of money over a period of time specified by them. Using the latest technology these products are offered in a period of time that meets the need of borrowers. The speed that the application is processed, which is a more rigorous process than most mainstream lenders, is reflective of the just in time economy and does not detract from the rigour of the process.

Short-term lenders have also led the way in improving data sharing, working with credit reference agencies (CRAs) to develop real-time data sharing. 90% of the market by volume is already committed to sharing data on a real time basis. Mainstream lenders now need to follow suit and help ensure that all lenders have a full picture of an individual's financial position on which to base lending decisions. This would reduce the need for broad brush assumptions that may work against customers with so-called 'thin' credit records.

Increasing numbers of consumers lead non-traditional lifestyles, resulting in demand for short-term credit. Technology enables this demand to be met, but the consequences (including default costs) of not having access to this credit often exceed the actual costs of the loan

Technological advances have meant that consumers increasingly expect a rapid response, in terms of shopping and services. Financial services has developed (and is continuing to develop) in the same way. Speed of delivery should not be seen as negative. Many consumers who use short-term loans do so to meet immediate financial needs, such as urgent car repair costs or paying bills when wages are paid late. Being unable to access immediate funds could put some consumers at increased risk of financial exclusion because they incur deferred and long-term debts.

How has the financial downturn changed the nature of financial exclusion?

The financial downturn has seen increased numbers of consumers at risk of financial exclusion and different degrees of exclusion, with many who were previously able to access mainstream credit now unable to do so.

Action taken by Governments and regulators to shore up the financial position of banks is not always in the best interests of consumers. As a result of new prudential requirements, banks have become more cautious about lending and more selective about the customers to whom they lend.

An increased number of consumers have volatile incomes as a result of the financial downturn. Many people have more than one job, are self-employed (25% of the working population) or on zero-hours contracts (5 per cent of the working population), all of which affect both stability and

levels of income. The effects of these non-traditional lifestyles can include increased difficulty in obtaining credit, and in some cases increased difficulty in obtaining basic banking services.

Can technology help deliver better transactional banking services for people on low or unpredictable incomes?

Use of technology can mean that firms are able to reduce costs and serve more customers as a result. Policymakers and regulators need to embrace the use of technology to help customers. The growing ecommerce world means that customers expect products and services to be delivered quickly, financial services is not, and should not, be any different. Reduced ability to obtain funds in a short period of time may in fact lead to customers becoming financially excluded, for example individuals who incur additional charges as a result of a missed payment or whose credit record worsens as a result of a default being recorded against them.

There are some consumers who do not have internet access, some with very slow connections due to the area they live in, and others who simply do not want to use the internet for financial services transactions, for example because they are uncomfortable providing private information online. There are also limits to technology. For example there is still a need to be able to access free cash withdrawals and although the developments in cheque imaging are good, they will not work for everyone.

Technology is not the answer to everyone's needs and a high street presence remains important for many customers. As such there will be a continuing role for financial services on high street, both in traditional form (banks and building societies) and other forms, including short-term lenders. In particular, consideration needs to be given to the different groups of consumers who are more likely to use high street outlets, such as women. Analysis by the Competition and Markets Authority (CMA)[6] found that high street customers for short-term credit are, in comparison with online customers, more likely to:

- have no qualifications;
- be on a low income;
- have no bank account;
- be unemployed or work part-time;
- rent from local authorities;
- be over 45;
- be black or Asian;
- be female and/or lone parents.

Is there scope to bring people into mainstream credit who are currently excluded, while also ensuring that this does not risk financial difficulty?

Using short-term loans should not be seen as a negative factor if individuals have repaid loans on time. Repaying any loan on time should help consumers build up their credit rating. Too many firms, commentators and politicians make judgments about individuals based on the type of credit they use rather than the way in which they use it.

A wider variety of financial information should be used to inform credit ratings. For example where a household which pays rent consistently on time, this should be recorded as positive financial

[6] Local Competition Working Paper, CMA, February 2014, https://www.gov.uk/cma-cases/payday-lending-market-investigation

information. Recording additional information like this will help individuals and households to build up a positive credit rating more quickly than would otherwise be the case.

The short-term loan industry is leading the way on data sharing, lenders need information about all of an individual's finances in real time on which to base a decision. The rest of the financial services industry needs to follow suit.

<u>For people who are unlikely to qualify for mainstream credit, what might affordable alternatives be? Should banks, building societies and others play a role in provision?</u>

Short-term loans are an affordable alternative form of credit, particularly after implementation of the price cap, but this requires regulators to focus on ensuring the standards of licensed operators is high, rather than aggressive regulation that unreasonably restricts supply and prevents well run operators from providing credit where others will not.

There needs to be recognition that some individuals represent a higher risk and some forms of credit are more risky than others, as such some credit is likely to remain more expensive in comparison with mainstream credit. Banks, building societies and credit unions can all play a role in widening the availability of affordable credit. But to do this, these institutions need to acknowledge that existing products may not be fit for purpose and focus instead on developing products that do meet consumer need.

The Government should also consider what role it should play, for example in providing more in the way of crisis funding for those who do not have other realistic options and have been excluded from high-cost short-term credit as a result of regulatory change.

Any work to develop solutions should start from an assessment of real need rather than ill-informed decisions made by policymakers who have not had any experience of being in financial difficulty or being financially excluded.

<u>How does credit scoring contribute to financial exclusion, and are there viable alternatives to traditional credit scoring?</u>

Many lenders have their own bespoke credit scoring models which build on the models developed by credit reference agencies (CRAs). These models use information from CRAs together with a range of other information about individuals in order to make robust lending decisions.

Short-term lenders have led the way in developing innovative ways of combining the information available to assess an individual's credit position. Real-time data sharing is an important part of this and the rest of the consumer credit industry now needs to catch up and increase both the amount and frequency of data shared.

Consideration needs to be given to recording a wider range of information, particularly positive information, to build a more detailed picture of an individual's financial position and help those who may have been financially excluded to build up a more positive credit rating. This in turn will lead to customers who display good borrowing behaviour being able to benefit from better prices as lenders adopt risk-based pricing models.

<u>What reforms could be considered to ensure consumers getting into financial difficulty are protected including those who become insolvent?</u>

Debt derives from many different sources and any work looking at debt should consider all the sources of debt rather than simply focussing on one specific cause. People in the UK owed £1.459

trillion at the end of September 2014, while outstanding unsecured consumer credit lending was £106.6 billion at the end of September 2014. To give an idea of the proportion of unsecured lending represented by payday loans, based on Competition and Markets Authority analysis, during financial year 2012 (when the market peaked), payday lenders issued approximately 10.2 million new loans worth around £2.8 billion . Other debts are also rising, StepChange the debt charity reported that in the last five years there has been a significant increase in the proportion of their clients with arrears on essential household bills, such as council tax and utility bills.

CFA members explain the cost of a loan, alert customers when a payment is due, provide breathing space to customers in financial difficulty and signpost customers to free independent debt advice. Given the nature of short-term lending, it is arguable that lenders have more direct contact with their customers and are more flexible when they need help than many mainstream credit providers.

The concept of forbearance and treating customers fairly should be a universal concept that should apply to all organisations seeking to recover their debts, be it consumer, commercial or government debt. All creditors should be required to deal with people in financial difficulty in the same way. In particular HMRC and local authorities need to come in to line with financial services companies in terms of offering forbearance and repayment plans. A common standard would raise standards overall and provide a clear benchmark to measure all businesses against.

Should policymakers enable and encourage people on low incomes to save, particularly in the economic downturn?

Even small amounts of saving can make a big difference to the financial position of individuals and households, helping to smooth the peaks and troughs of consumption

Increasingly debt advice charities – such as the Debt Counsellors Charitable Trust – are encouraging people to save in credit unions at the same time as repaying outstanding debts. The Consumer Finance Association and members are exploring ways of encouraging their customers to save through credit unions as well as borrowing credit.

What practical steps could be taken to foster a savings culture in the UK?

Steps to encourage saving could include:

- Encouraging people to start saving a small amount on a regular basis at the same time as repaying their debts, following the model being trialled by the Debt Counsellors Charitable Trust;
- Encouraging saving from a young age, for example in schools;
- Financial incentives for saving, potentially targeted at those most at risk of being in financial difficulties. The incentives used in other jurisdictions should be evaluated. The success of the previous Savings Gateway should also be evaluated, for example are those who benefited still saving?

Conclusion

There is no one size fits all approach to tackling financial exclusion. Any work to develop potential solutions should start from the point of understanding what consumer needs are. All too often judgements and policies are made by those who have no understanding of the real needs of the vast majority of consumers.

The single measure that would help tackle financial exclusion would be a requirement for the Financial Conduct Authority (FCA) to consider the position of those who will be excluded from some

element of financial services as a result of the regulatory approach of the FCA. The main focus currently is on preventing or reducing harm to consumers from accessing the 'wrong' product with little attention paid to the harm caused by not being able to access that product, or in some cases being unable to access any products at all.

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