FCA Call for Input: High-cost credit – Responsible Finance Response
15 February 2017

About Responsible Finance and this submission

Responsible Finance is the trade body for responsible finance providers (also known as community finance organisations). Responsible finance providers provide loans and support to businesses and individuals who find it difficult to access finance from commercial banks. Responsible Finance's mission is to support the development of a thriving and sustainable sector that provides finance for underserved communities and, as a result, contributes to the increasing economic growth and prosperity of these communities.

The following submission from Responsible Finance comes following a consultation with our member organisations. Our members work mainly and directly with the customer segment that borrows high-cost credit. In any response to high-cost credit lending, there should also be efforts in tandem to support access to ethical finance providers, such as community finance organisations.

Q1: 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 FCA's definition of high-cost credit has so far focused on payday lending. Although the proliferation of payday lending caused significant consumer detriment, there are other forms of high-cost credit beyond payday lending that have not been subject to the same regulatory scrutiny. Our members identified the following products as of particular concern:

- Catalogue credit
- Home-collected credit
- Rent-to-own
- Guarantor loans
- Logbook loans
- Pawnbrokers

Although the products above are diverse, they target the sub-prime segments of the market. The significant costs in accessing these high-cost products result in consumers becoming more vulnerable to financial shocks and spending more of their disposable income on servicing credit.

Therefore the FCA should include these products in its remit of high-cost credit, and approach them with a consistent approach in terms of requiring these firms to provide much more clarity to customers about the cost of credit, more stringent affordability checks, and a potential cost cap. High-cost firms should also be required to signpost to affordable alternatives such as community finance organisations, or debt advice charities.

It should become common practice that, should consumer detriment be identified in one product segment and remedial measures be introduced, other high-cost credit products also are looked at to ascertain whether extending the measure to that product family would benefit the consumer. This would make the regulatory response more consistent and serve two purposes. Firstly, once consumer harm is identified in one market, looking at other adjacent products for harm would increase the chances of detriment being identified in those markets at an earlier stage. Secondly, it would mean rollout of remedial measures would happen on a larger scale.

Q2: To what extent is there detriment from high-cost credit products (other than HCSTC)?

Our members work with consumers that are furthest away from the mainstream credit market. Their customer demographic is weighted towards: adults of the age to have young children; people living alone including single parents; people socially renting; people on benefits often impacted by ill health/disability and facing child or other caring responsibilities as barriers to work. The majority of their customers have used some form of sub-prime credit in the last five years (including catalogue credit, rent-to-own, home credit, and pawnbrokers).

The significant costs in accessing such high-cost products result in consumers spending limited disposable income on the cost of credit, and therefore may be more susceptible to financial vulnerability. Longer term products such as catalogue credit and rent-to-own, can result in consumers paying charges over a long period of time. These firms tend to be inflexible with their terms, and set low minimum payments, plus compound interest, so the consumer is essentially locked into charges over a number of years. Anecdotally, we were made aware of a case where a consumer borrowed from rent-to-own for a value of £500, and eventually repaid £88,000 over 5 years. This type of detriment is very damaging to individuals' life chances and should be an area of focus for the FCA.

Q3: 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?

With other high-cost products outside of HCSTC consumer detriment arises as a result of the rules not being directly targeted at these firms. For example:

- **Logbook loans**: Logbook loans are currently excluded from the FCA price cap in 2015, so these firms were able to charge high interest rates.
- **Guarantor loans**: The guarantor is not fully aware of their liabilities by the firm if the borrower fails to make the repayments.
- **Home-collected credit**: Firms are not doing enough in the way of affordability checks assessment to ensure the loan repayments are affordable. Customers are still being approved for new loans when they have recent defaults on other financial products.
- **Rent to own**: Customers are paying for expensive compulsory service packages, and are not made aware of the total cost of credit.

In most of these cases, because they do not fall under the HCSTC rules, these firms are not being fully transparent about the cost of their products in their promotions, and do not have stringent affordability checks in place.

Q4: If there is detriment arising from matters not addressed by our rules, what sort of interventions should we consider? What would be the impact?

Interventions for the broader high-cost market should generally follow the rules for HCSTC: requiring firms to provide much more transparency to customers about the cost of credit, more stringent affordability checks, and a potential cost cap. Requiring firms to make their customers aware of alternatives such as community finance organisations and debt advice would also increase choice and awareness for consumers.

It is important to recognise introducing checks on high-cost credit, even to protect the consumer, is likely to reduce credit options for those who are already financially excluded – as has been seen in the payday market. It can exacerbate a move towards borrowing informally, either from friends or family or, at worse, via illegal and unregulated lenders. Any regulation applied to these products should be developed in tandem with the expansion of ethical and affordable alternatives such as products provided by community finance organisations. This includes maintaining the exemptions on HCSTC rules for community finance organisations. This exemption is an important distinction for community finance organisations as ethical lenders that provide access to affordable credit, but as not-for-profit organisations are not operating on a level playing field with commercial lenders.

Q5: Should some of the HCSTC protections be applied more widely? What would be the impact on the cost of or access to credit?

A similar approach should be taken to the range of high-cost credit products as is taken with HCSTC. The impact would be to increase awareness about the cost of borrowing, potentially reduce the cost for the consumer and it may also reduce the number of providers. This in turn could potentially reduce access to credit for customers and increase the market for illegal lenders. As stated previously, any intervention applied to other high-cost products should be developed in tandem with the expansion of ethical and affordable alternatives such as products provided by community finance organisations. High-cost firms should also be required to signpost to affordable alternatives such as community finance organisations or debt advice charities. Community finance organisations and debt advice charities are not-for-profit organisations, typically have small marketing budgets and do not always operate on a level playing field with commercial firms.

Q6: To what extent do you think overdrafts are a substitute, or alternative, for other high-cost credit products?

The consumers that our members work with are typically excluded from mainstream banking services and only a minority have used an overdraft facility or a credit card. For this reason we are not experts on the use of overdrafts and whether they are being used as a substitute for other high-cost products.

Q7: What do you think are the key issues the FCA should consider on arranged and unarranged overdrafts respectively?

As mentioned previously, we are not placed to comment in detail on the use of overdrafts. However, a key issue that our members have identified in their experience, is that the wide variety of fee/charge structures on overdrafts makes it difficult for consumers to compare alternatives upfront. Many of the charges levied on consumers do not typically bear a true reflection of the actual cost to the firm.

Q8: What measures could be taken to address these and what would be the risks and benefits? Section 2: HCSTC price cap review

In order to address this issue, a standardised way of comparing fees (similar to the regulations around APR) could be introduced. This would make comparing accounts easier for the consumer. Banks could also be required to provide more information to the consumer, alerting them when they are approaching their overdraft limit.

As with other interventions, this could reduce the number of options available. A potential cap on monthly/annual fees for overdrafts could potentially have this effect as well.

Q9: 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**

In our members' experience, the demand for finance remains high, with many of our members providing record amounts of affordable finance in 2015 and then again in 2016. Therefore it is likely that the trend in the reduction of applications will likely plateau.

Our members continue to see a high volume of clients using HCSTC, and a perception among clients that it is 'easy' to qualify for a HCSTC loan. In some cases our members have observed that clients with recent HCSTC loans suggest that KYC and affordability checks are still not as thorough as they should be.

Q10: 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?

N/A

Q11: Do you have any evidence of adverse consequences for consumers as a result of being declined for HCSTC?

There are anecdotal reports of consumers having used illegal money lenders in the past when they were unable to access a HCSTC loan. Consumers also turn to friends and family to borrow, which can have adverse consequences as well.

Q12: Do you agree that consumers do not generally move to other high-cost credit products as a result of being declined for HCSTC?

Our members report that the demand for finance in the sub-prime market remains at high levels. Macro-economic and societal trends suggest that this will not change with incomes stagnating, many people on zero-hours contracts and the introduction of universal income which will generally mean lower net income for many. In the meantime, the cost of living continues to drift up, as does inflation and the cost of goods. Therefore, it is likely that the demand for external finance will continue; it is important that consumers are made aware of affordable alternatives such as community finance organisations, so that they do not turn to illegal lenders.

Q13: What are the implications for consumers of increasing loan duration for HCSTC?

This potentially leads to the consumer paying more overall for credit, if they are repaying over a longer period of time.

Q14: 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?

N/A

Q15: 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)? Section 3: HCSTC repeat and multiple borrowing

We have not seen any evidence that firms are evading the HCSTC price cap in any way.

Q16: What are your views on our analysis of the data and market with regard to repeat and multiple borrowing?

N/A

Q17: Do you have any further evidence on repeat and multiple borrowing?

N/A