Responsible Finance

FCA Call for Input: Review into Change and Innovation in the Unsecured Credit Market (The Woolard Review), December 2020

About Responsible Finance and our response

Responsible Finance is the trade association for Community Development Finance Institutions (CDFIs) in the UK.

We believe in a fair financial system where investment flows into communities to create positive economic, social and environmental impact. To enable this, we are leading a strong responsible finance sector so communities have access to finance to transform lives. Our members make loans in disadvantaged communities that are not adequately served by mainstream financial service providers.

CDFIs are mission driven not-for-profit organisations that provide affordable credit and support to people who may otherwise borrow from high-cost lenders or be forced to go without.

Access to affordable credit improves the wellbeing and resilience of individuals by offering them a tool to smooth fluctuating incomes, cover unexpected calls on their finances, or pay for expected larger expenses. Alongside this they offer wrap around services such as helping people to claim benefits and providing budgeting advice. By empowering people to take control of their finances, CDFIs help them to save money in lower interest payments compared to high-cost credit, reduce stress and meet essential needs.

We welcome the opportunity to respond to the FCA's Woolard review. We believe it is important to review the consumer credit market now, when the negative financial ramifications of the Covid-19 pandemic and lockdowns continue to hit communities across the UK, to ensure the regulator can respond to the challenges facing customers and boost personal financial wellbeing through the recovery period.

This response focuses on Community Development Finance Institutions who make personal loans. These predominately fall into the FCA's definition of a Community Finance Organisation, with some exceptions. One member of Responsible Finance is a social enterprise which makes personal loans specifically to NHS employees, either as salary deducted loans or by taking repayments via direct debit.

Throughout the Covid-19 crisis CDFIs have flexibly supported their customers and pivoted their strategies to support those most in need. This response is based on feedback from regular network meetings with CDFIs throughout the crisis, and from other relevant research.

We are happy to be contacted to provide further detail on any of the points made within this response.

Your thoughts on the unsecured credit market

Theme 1 – drivers and use of credit

Q1: Please provide evidence and/or views on the current state of the market, as well as key changes and trends around:

Since the FCA began regulating the consumer credit market in 2014, due to its substantive intervention the state of the market has improved. Price caps, tighter business restrictions, and more rigorous affordability requirements have generally led to better consumer outcomes for those accessing high-cost credit.

Despite this, the unsecured credit market does not work well for many people. Three million consumers use high-cost credit[1] and low-income consumers are most likely to do so[2]. Unequal access and use of financial services has been linked to inequality and poverty[3], and recent research from CDFI Fair For You found that customers who had borrowed from high-cost lenders in the 12 months prior to using Fair For You reported a range of problems including money-related stress and anxiety, cutting back on food and essentials, and struggling to pay household bills. These customers often felt harassed by their previous lenders[4].

A recent report on the poverty premium from the Personal Finance Research Centre at the University of Bristol showed a mixed picture of change in the cost of high cost credit. Comparing the cost of credit in 2016 and 2019, it found:

- The costs of buying goods using rent-to-own credit has decreased from £315 on average to £182.
- The cost of using mail order catalogues has dropped by £118 pa on average.
- The costs of loan finance from subprime loans, short-term loans and home-collected loans have all increased.
- The costs of subprime credit card use have also increased.

The report suggested that the cap on the cost of rent-to-own contacts may have had a positive impact on consumers, however, in general higher-cost credit is more expensive that it was in 2016, bringing into question the impact of the caps in the long-term on the whole of the consumer credit market[5].

Access to credit is an essential service for many households and can be central to financial stability. Restricting access may push demand underground. Research has found that a significant proportion of people who had been denied for 'payday' finance continued to look for other borrowing options. This is contrary to the original prediction that 60% of borrowers with no access to high-cost credit would no longer borrow at all, and means the landscape remains complex[6].

Evidence is limited, but there are anecdotal stories such as from Stop Loan Sharks of consumers borrowing £50 from a loan shark and being forced to pay back £35,000 over time[7].

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[1] Financial Conduct Authority (2019) Alternatives to High Cost Credit Report. Available: https://www.fca.org.uk/publication/research/alternatives-high-cost-credit-report.pdf

[2] Joseph Rowntree Foundation (2016) Housing Association Innovation in Delivering Affordable Credit. Available: https://www.jrf.org.uk/report/housing-association-innovation-delivering-affordable-credit

[3] Biosca, O. et al (2020) Walking a Tightrope: Using Financial Diaries to Investigate Day-to-Day Financial Decisions and the Social Safety Net of the Financially Excluded. Available: https://journals.sagepub.com/doi/10.1177/0002716220921154

[4] Gibbons, D (2020) The Social Impact of Fair For You. Available: https://responsible-credit.org.uk/wp-content/uploads/2020/09/CfRC-Social-Impact-of-Fair-for-you-report-final.pdf

[5] Davies, S. Trend, L. (2020) The Poverty Premium: A Customer Perspective. Available: https://fairbydesign.com/wp-content/uploads/2020/11/The-poverty-premium-A-Customer-Perspective-Report.pdf

[6] Appleyard, L. et al. (2018) Payday Denied: Exploring the Lived Experiences of Declined Payday Loan Applicants. Available: https://www.toynbeehall.org.uk/wp-content/uploads/2018/11/Payday-Denied-Report.pdf

[7] Stop Loan Sharks (2020) Loan Shark Survivor Wins Hero Award After Sharing Her Story to Help Other Victims. Available: https://www.stoploansharks.co.uk/loan-shark-survivor-wins-hero-award-after-sharing-her-story-to-help-other-victims/ (accessed 27/11/2020)

Other research has found that low-income individuals with limited access to financial services, and people denied for high-cost credit, predominately turn to friends and family. Whilst this might be considered positive, there is often a significant human cost to families, relationships and dignity, particularly where people borrow from others who are also cash-strapped. Whilst informal loans from friends and family are interest free, there are perceived costs in terms of the consumers having to reciprocate to ensure they can rely on this source in future, even if their own financial situation is insecure. This often means consumers' using others' credit cards and catalogue subscriptions as a form of payment. This may affect their own and others' credit scores, and contribute to deepening financial exclusion in low-income communities. The damage this can cause to these individuals' sometimes already limited social networks can be detrimental to their wellbeing[8].

Other people are being forced to go without when they cannot access credit, which can mean living without essential appliances and being pushed into hardship[9]. We recommend that more research is done to understand the financial lives of people who are unable to access credit. This would be useful in informing the design of supportive declines.

Evidence has found that inclusive financial systems can improve individual welfare by improving consumers' ability to manage risk, smooth consumption, and 'cushion against asset-depleting strategies after an economic shock'[10]. Affordable financial products such as those from CDFIs also support people to build up their credit histories, improving their financial security and future ability to access mainstream lower cost credit. It is clear that people need access to more and better credit products, particularly in the wake of the Covid-19 pandemic, yet there are significant hurdles still to overcome.

We welcome Fair4All Finance's interventions aimed at scaling the affordable credit sector, and HM Treasury's development of the No Interest Loans Scheme (NILS) for consumers who can afford to borrow but not to repay interest. The CDFI sector is collaborating with Fair4All Finance, Toynbee Hall and Fair By Design to inform the design of the NILS scheme, and have offered to use their digital infrastructure and significant coverage of the UK to help deliver it alongside other affordable credit providers including credit unions.

To build on the positive work being done to ensure the affordable credit sector reaches those who need it most, now and in the future, we recommend:

- **The development of sustainable long-term funding for affordable credit providers.** Access to long-term patient capital is essential for scaling the community finance sector.

  Continuity of capital allows for investment in infrastructure and the employment of new staff. This was illustrated in the enterprise lending CDFI sector where the Government's Regional Growth Fund, delivered by the sector since 2012, provided a step-change for its scale and sustainability.

[8] Biosca, O. et al (2020) Walking a Tightrope: Using Financial Diaries to Investigate Day-to-Day Financial Decisions and the Social Safety Net of the Financially Excluded. Available: https://journals.sagepub.com/doi/10.1177/0002716220921154
[9] Appleyard, L. et al. (2018) Payday Denied: Exploring the Lived Experiences of Declined Payday Loan Applicants.
[10] Biosca, O. et al (2020) Walking a Tightrope: Using Financial Diaries to Investigate Day-to-Day Financial Decisions and the Social Safety Net of the Financially Excluded.

Partnerships with mainstream financial services providers, such as banks, would provide a long-term source of funding for the sector whilst helping banks to fill the gaps where they are unable to lend.

In addition to filling the gaps, affordable credit providers support consumers to build their financial stability so they can eventually access cheaper mainstream credit. This market of potential customers for banks should act as an incentive for them to partner with CDFIs.

In other countries, such as the USA, legislation exists to incentivise the mainstream to partner and invest into the community finance sector, fulfilling the banking sector's social obligations.

- **Awareness raising amongst key organisations is essential in helping to permanently reroute individuals away from high-cost credit and into affordable credit.** Housing associations, local authorities, social and private landlords and employers all have a duty to the financial wellbeing of the individuals' associated with them. They could play more of a role in raising the profile of the affordable credit sector.

  Awareness of the much welcome changes to the regulatory boundary for credit broking for social housing providers is very low. Whilst we are working to remedy this, barriers still exist and the CDFI sector has limited marketing resources. Again, sustainable access to capital and resource would allow the sector to step-up its profile-raising and outreach efforts.

  We welcomed the Money and Pensions Service Challenge Chairs' report which recommended carrying out a programme of awareness raising. We believe this is vital and timely. It should seek to raise awareness of affordable credit providers amongst both the general public and key stakeholders, such as those listed above. Special efforts should be made to champion the CDFI sector, as well as credit unions.

  As part of the programme of awareness raising we recommend creating a simple portal that acts as a gateway to approved affordable credit providers. Customers would be able to view CDFIs and credit unions, the products they offer and the communities they serve, including being able to set a preference for online borrowing or face-to-face. This would support individuals to make informed decisions about which lender is most appropriate when they need credit, and give them the peace of mind to know they are using a provider whose incentives are matched with their own.

  The portal should also contain information on debt advice, other support and potential grant options available to customers.

- **Parity of support in the devolved nations.** Fair4All Finance's scale up programmes and other work has been transformational for some affordable credit providers in getting them on the path to scaling to meet need. Unfortunately, CDFIs and credit unions in Scotland, Wales and Northern Ireland are not able to access their support and funding. Given that there is high dependence on high cost credit in Scotland, Wales and Northern Ireland, it is crucial that Fair4All Finance's operations are extended across all four nations of the UK, with commitment from the devolved Governments.

Case study – putting loan sharks out of business

Fair Finance is a CDFI based in London. It was established 15 years ago. One of its earliest clients had borrowed £250 for a headstone for her husband's grave from a lender informally known as 'loan man Dave.' She had paid him back over £2,500 but she still owed him £250 when she went to Fair Finance to refinance her loan. Within four months of receiving a loan from Fair Finance she was debt-free.

A few years later 'loan man Dave' approached Fair Finance and asked for a job because they had put him out of business – his clients were choosing Fair Finance.

CDFIs have the potential to put many more high-cost lenders and loan sharks out of business, if they continue to be supported to scale, their profile is raised, and they have access to long-term patient capital.

a) who is using unsecured credit and for what purposes

The characteristics of customers who use CDFIs mirror those of other exclusions linked to poverty and deprivation. In 2017 the FCA found that 50% of UK consumers showed one or more characteristics of potential vulnerability, such a limited financial resilience and low financial capability[11]. This vulnerability is more severe in low-income groups, where it is exacerbated by sometimes irregular income and peaks in expenditure with no savings buffer to cover costs. This can drive the use of unsecured credit. Seasonal pressure points that drive demand for credit amongst CDFIs' customers are Christmas and the summer holidays.

In 2019 the characteristics of CDFIs' customers were:

- 48% Unemployed
- 50% Social housing occupants
- 64% Benefits recipients
- 52% On household incomes of less than £15,000
- 50% Living in a household with dependents under the age of 18
- 36% Single parents
- 21% Living with a disability
- 35% Male
- 65% Female
- 17% of loans were to individuals from Black, Asian or Minority Ethnic backgrounds
- 27% Under the age of 30
- 6% Over the age of 65

Some CDFIs have seen an evolution in their client base over the past 15 years. London-based CDFI Fair Finance's typical customer 15 years ago was often female, not working, living on a low but stable and regular income from benefits, with limited economic mobility. They were often Bengali, Somali, Vietnamese or Afro-Caribbean and had a thin digital footprint.

[11] Financial Conduct Authority (2017) Understanding the Financial Lives of UK Adults. Available: https://www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf

Between 2009-2013, Fair Finance's client base changed as it began to receive applications from people affected by the 2008 global financial crisis. These were people who had previously been able to access to mainstream finance and had steady jobs, but now earned less and worked part-time, sometimes with multiple jobs and on zero-hours contracts. Their credit histories had been damaged by missed payments, leaving them unable to access mainstream products. These customers were digitally comfortable. New lenders entered the market at this time and took advantage of these people who were struggling to balance their finances.

With the increased uptake of online lending, many CDFIs saw a new profile of customer emerging. These customers tend to use high-cost credit regularly because they prefer online customer journeys and speed of access.

From 2014 onwards a new cohort of customers emerged for London-based Fair Finance. They are aspirational, hard-working immigrants, working in the UK and sending money home to their families. When these consumers arrive in the UK they have no credit history, and their circumstances mean they often remain financially vulnerable for long periods of time.

After the onset of the pandemic, Fair Finance commissioned Shift Design charity to analyse the impact of the pandemic on its existing customer base. Shift Design broke their customers into three distinct groups:

1- People predominantly already living on benefits with a low but stable income
2- People in jobs who were furloughed; their income had decreased but it was stable
3- People whose income or work had been variable before Covid, in zero-hours jobs or unstable self-employment, whose finances were suddenly put under major stress

Anecdotally, this customer impact has been mirrored across other CDFIs.

As of March 2020 CDFIs have been receiving more online applications from individuals who are heavily overindebted with a range of credit products, and who have significant gambling debts. This is a concerning development which needs a holistic response, including debt advice, possible consolidation and other support services.

We recommend more and consistent research is done to gain insights into the lives of customers who use consumer credit, those who cannot access it, and experiences of using credit or being declined.

b) how unsecured credit is marketed by firms and how it is viewed by consumers

CDFIs have limited marketing budgets so are unable to compete with high-cost credit providers in their advertising efforts. CDFI credit is viewed as a service to fund essential credit requirements rather than encouraging the use of credit for non-essential spending.

High-cost credit firms including payday lenders use digital technology to target individuals who have expressed an interest in accessing credit online to bombard them with credit-linked propositions. This can encourage the inappropriate take-up of credit and does not take into account a customer's wider financial status.

c) the impact of big data and digital technology in this market

Big data and digital technology have the potential to have a positive impact on UK customers and society as a whole, however there are potential harms and it is not yet clear if it is leading to better outcomes for consumers.

Increased auto-processing of loan applications by lenders using algorithms can have inbuilt bias and do not take into account unique consumer circumstances, thereby can result in inappropriate lending decisions or the financial exclusion of customers. Big tech gives the power for monopolistic firms to manipulate individual consumer behaviours into making sub-optimal decisions, such as to take out high-cost credit.

Despite this, the development of open banking has provided a step-change in credit markets, and offers lenders and credit scoring companies the opportunity to include a wider range of data when assessing affordability and producing credit scores. Credit scores often do not offer a fair reflection of a person's ability to repay future loans. For example, consumers who have a 'thin' credit history or whose financial situation has improved since defaulting on payments in the past. The impact of open banking in this space offers the potential for more accurate affordability assessments, greater inclusion for customers who may previously have been excluded from accessing finance, and a potentially reduced cost of credit.

CDFIs have embraced the new opportunities presented by open banking by using it to make more accurate affordability checks on their customers. The opportunities that open banking can bring are still being explored by CDFIs, including where open banking can enable better budgeting through apps and preventative financial health monitoring. Some CDFIs offer their customers free access to budgeting apps, such as Scotcash, a CDFI based in Glasgow, which now offers its customers access to free money management app 'Snoop'. This has had high-levels of take-up from its customers.

Nevertheless, it is well documented that the CDFI sector has limited resources to invest in technology, data and behavioural insights, and therefore digital technology tends to be underutilised. Given that CDFIs' mission is aligned with that of their customers - to improve financial wellbeing and stability – they are well placed to trial initiatives that aim to improve outcomes for consumers.

The limited resources of both time and capital that affordable credit providers have should be considered when designing innovation challenge funds and sandbox events. CDFIs have skills and knowledge, but are often too resource and capacity constrained to participate.

The Government could encourage innovation and the use of big data and digital technology in CDFIs by supporting the sector to raise long-term patient capital. A sustainable source of this could be by encouraging partnerships with the UK's banks; such as is the case in the U.S. Without access to long-term sources of capital and the certainty of trajectory this brings, it is difficult to invest in new technologies.

The risks that open banking and the development of open finance pose to UK consumers should not be underestimated or left to run their own course. A recent briefing from the Centre for Responsible Credit stated that 'there is virtually no aspect of an individual's life which lenders cannot claim is relevant to risk assessment. The pandemic may, for example, result in a drive for access to health data: whether a borrower falls within a social grouping that is vulnerable to the virus could have a bearing on their ability to repay.[12]'

Ongoing and frequent monitoring, evaluation and review of how these technologies are being used is vital to ensure potential harms are picked up and remedied early.

Q2: What are the main trends and challenges created by these changes?

As above.

Q3: What are the likely dynamic changes you expect in the market, and what might the biggest effect of these be?

It is reasonable to assume that in the near future demand for credit is likely to rise very significantly given the expected long-term negative consequences of the Covid-19 pandemic on household finances. At the same time, due to the mass take-up of payment deferrals by consumers and the issues in how these are reported to Credit Reference Agencies, and thus the impact on consumers' credit files, it is likely that consumers will face reduced access to credit[13] from commercial lenders. In the medium to long-term, the shift to a net-zero economy will mean that industries and regional economies will change rapidly. Low income communities are at greatest risk for job losses, and as Covid-19 has demonstrated, financial resilience and access to fair credit is crucial for consumers to navigate these macro-economic changes.

In this context, CDFIs must be well capitalised and visible to respond and divert consumers away from high-cost credit providers. CDFIs can help consumers to stabilise their finances and build their credit scores, as well as acting as a gateway to other support and advice services, including the No Interest Loans Scheme.

CDFIs have the ability to respond to increased demand and scale up; but in order to do so they need continuity of capital. As above, we recommend supporting partnerships between the UK's mainstream banks and affordable credit providers to provide this.

Q4: What do you see as the main drivers of demand for credit? How do they affect consumer demand for credit now and in the future?

Prior to Covid-19, changes in the nature of work such as the rise of the 'gig' economy, and shifts to welfare policies meant many individuals had high month to month income volatility. Having decent and stable income is essential for financial resilience. For individuals on low, unstable incomes, it can be difficult to manage short-term fluctuations in income as they often have limited assets and savings. This drives demand for credit.

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[12] Gibbons, D. (2020) Credit, Risk, and the Pandemic. Available: https://www.birmingham.ac.uk/documents/college-social-sciences/social-policy/chasm/briefing-papers/covid19/chasm-bp12-2020.pdf
[13] Ibid.

According to StepChange debt charity, unemployment or redundancy is the most common reason for debt, affecting 16% of their new clients[14]. With record numbers of people being made redundant, and more redundancies predicted in the coming months, it is important that consumers are not driven into borrowing from high-cost lenders.

Another evident factor that drives demand for credit for CDFIs' customers is a lack of money management skills, and awareness of impact of non-payment and arrears on credit profile and subsequent ability to access fairly priced credit.

Q5: Which consumer groups currently struggle to access the credit market, and why? How has this changed over time and how do you expect it to evolve?

Low-income vulnerable consumers are more likely to default on loan repayments, and have low credit-scores, therefore they often struggle to access mainstream lower cost credit. CDFIs' customers reflect the customer cohorts which are unable to access the mainstream credit market, as described in question 1A. Whilst there have been changes in the demographics of clients using CDFI finance, the general characteristics of their consumers broadly mirror those of other exclusions linked to poverty and deprivation, which tend to remain consistent.

CDFIs take a range of factors into account when making affordability assessments including looking at the applicants' proportion of disposable income and other credit agreements. In recently months CDFIs have received a raft of applications from people who are heavily over-indebted. CDFIs are unable to lend to these people where it is the case that another loan would likely worsen their financial situation. As discussed later in our response, a consolidation product could be an appropriate option for these consumers, delivered holistically with debt advice and support.

Prior to Covid-19 research found 5.8 million Britons were excluded from mainstream finance because they had little or no financial information linked to them[15]. This means they are often declined for financial services or pay a higher cost for access. These people come from a variety of backgrounds, and the lack of information may be down to a number of reasons, such as being in a relationship where a person's partner has been responsible for managing the finances or never having had a credit card. As discussed above, improvements in credit scoring driven by open banking could help to remedy this.

As the full impact of the pandemic plays out in the coming months, a new cohort of customers who have never previously experienced financial vulnerability will likely struggle to access the mainstream credit market, therefore will be forced into higher cost forms of borrowing. These customers may not have used state benefits before, therefore will require additional support including advice and income maximisation services. CDFIs have redeployed additional resource to best assist these customers.

Q6: Do you agree that in a healthy credit market there will be people who will not be able to access credit? What are the characteristics of these people and what would the impact of not having access be on them.

The ability to access appropriate financial services is essential for a healthy financial life; therefore it is vital that lenders assess affordability thoroughly to ensure credit is appropriate for each customer.

[14] StepChange (2020) Debt Advice During Coronavirus. Available: https://www.stepchange.org/Portals/0/assets/pdf/stepchange-covid19-data-report-july-2020.pdf

[15] Experian. (2018). 'Britain's unseen problem: 5.8 million people 'invisible' to the financial system', available: https://www.experianplc.com/media/news/2018/britain-s-unseen-problem-58-million-people-invisible-to-the-financial-system/, accessed 26/11/2020.

Credit is not always the best solution, particularly where it will leave a customer with insufficient money to cover expenses or too limited disposable income, leaving them vulnerable.

Where credit is not the best solution, lenders should signpost individuals to more appropriate services and other support. As discussed above in more detail, the lives of people who are unable to access credit should be mapped out to ensure they are receiving sufficient support, and to assess the extent of the butterfly effect on hardship and breakdown of social capital.

The No Interest Loans Scheme will form an important part of the patchwork of support for individuals who cannot afford to borrow interest-bearing loans but still need credit to stop them from slipping into unacceptable hardship.

When a customer is declined for credit, it can be an important moment to triage them for support which they may not know existed. Explaining to people who cannot access credit why they have been declined, and offering helpful alternatives and support, can help to direct them to a pathway to better financial health. CDFIs do this as standard, and have been working to innovate and find ways of creating seamless support and referral pathways for their customers and applicants, particularly through online customer journeys.

Theme 2 – change and innovation in the supply of credit

Q7: Please provide evidence and/or views on:

a) The main areas of change, innovation and growth in the supply of unsecured credit

Buy-now-pay-later (BNPL) credit has become inescapable for consumers when shopping online due to increased take up by retailers, and for some people it works well as a means of spreading the costs of larger purchases.

The integration of BNPL into the shopping baskets of online retailers makes it possible for people to take out a large sum of credit in a single transaction, without understanding the implications of missing payments. The Money and Mental Health Policy Institute has found that people with mental health problems are more likely to use credit offered by retailers, to get behind on payments for these credit products, or are using the credit to buy things they can't afford[16]. BNPL can tempt people to overspend, and on average in the UK shoppers who use it owe £176[17]. It is clear that the use of BNPL can lead to serious financial harm.

Despite this, there is a lack of research on the outcomes of the use of BNPL for consumers. We believe that retailers should highlight information for customers on the consequences of missing payments, including potential damage to their credit score, and that retailers should not have BNPL as the default payment method when people are shopping online. Affordability criteria for BNPL lending should also be tightened up.

More research is necessary to understand the growth of the BNPL market and its impact on consumers to determine if further regulation is needed.

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[16] Money and Mental Health Policy Institute (2017) Buy Now, Pay Later: Problems with the Point of Sale Credit Market. Available: https://www.moneyandmentalhealth.org/store-credit-and-vulnerable-customers/

[17] Sproson, K. (2020) What is Buy Now Pay Latter? Money Saving Expert. Available: https://www.moneysavingexpert.com/loans/buy-now-pay-later/

b) The key pressures and challenges to the sustainability of firms supplying unsecured credit, including how these have changed over time and how they might develop in the future

A key challenge for CDFIs is in balancing the credit needs of individuals, particularly those who demonstrate affordability but have legacy debt issues which impair their ability to access fairly priced credit, with making lending decisions that result in good outcomes for both the customer and firm.

In addition, as discussed in previous questions, CDFIs face unique challenges around requiring scale-up funding and investment. This is improving through the introduction of key stakeholders such as Fair4All Finance, but there remains an issue of access to long-term patient capital for all CDFIs, including those in the devolved nations and those in England who have been ineligible for Fair4All Finance's targeted scale up programmes, yet still provide a vital service to their local communities. Volume of loans is a key challenge, and as CDFIs grow they can benefit from economies of scale and bring down their cost per loan.

c) New and emerging business models, including those making use of behavioural biases and income from other sources than the end consumer eg. employers, and how existing models may be adapting to change.

We welcome some of the new and emerging innovative business models, such as employer salary advance schemes (ESAS), that have the potential to act as an important tool for consumers who lack a financial buffer to meet one-off expenses. These schemes must be used responsibly with sufficient information provided to the consumer and suitable caps placed on the percentage of income that can be drawn down prior to their usual payday. We feel that the FCA is right in its approach to continue to monitor the ESAS market and its impact on its customers, particularly where the income is viewed as a security and is required to be paid into specific lender controlled accounts.

Salad Money is an example of an innovative business model having a positive impact on its customers in this space. It is a social enterprise which makes affordable loans of up to £1,000 for NHS employees, providing an alternative to high-cost lenders. Salad Money uses open banking to assess loan affordability and offers its customers free financial education. Depending on its relationship with each NHS Trust, repayments are either salary deducted or made via direct debit. Throughout the Covid-19 pandemic Salad Money has seen demand for its loans rise due to the increased pressure on family units; potentially caused by NHS employee's family members and partners being made redundant or facing reduced income.

Q8: Regarding unregulated credit or credit-like products:

a) What evidence can you provide of the increase in availability and uptake of these products?
b) What impact has this had on the regulated credit market and how might it play out in the future?
c) What are the characteristics of customers of these products?
d) What role do these products play in the wider economy?
e) What benefits, risks and harms do these products create? Is there more the FCA or other authorities could do to preserve benefits or address harms and risks?

N/a

Q9: Please provide evidence and/or views on:

a) **Where the gaps are in the supply of unsecured credit, and where they are likely to be in the future**
b) **The effect on consumers of any gaps in supply**
c) **The main barriers to a sustainable market developing to fill these gaps**
d) **What role the FCA, or others, could play in helping innovation and growth in these areas**

Discussed in earlier questions.

Theme 3 – the role of regulation in unsecured credit markets

Q 10: Do you think regulation drives similar outcomes for consumers who use similar or substitutable unsecured credit products?

As discussed earlier, the costs of different high-cost credit products have changed since 2016, with some becoming cheaper and others more expensive. The long-term impacts of the FCA's interventions should be monitored to ensure they are having the desired impact on the consumer credit market as a whole.

The outcomes for a customer using a high-cost credit company compared to a CDFI can have a significant detrimental impact, despite both organisations being regulated by the Financial Conduct Authority. On a £500 loan over 26 weeks a customer using a CDFI could expect to pay back around £650, whereas if they went to a high-cost provider they may pay back around £900. This is a significant cost for most people, but for the low-income customers who use these products the cost can dramatically impact on their quality of life.

We welcome the FCA's Guidance on the Fair Treatment of Vulnerable customers, and agree with its assessment that trying to set a standardised approach across sectors may lead to a levelling down and 'tick-box' approach to vulnerability. Active supervision and monitoring of consumer outcomes will be required to ensure that firms across the spectrum of the consumer credit market successfully implement the guidance to drive similar outcomes for individuals using unsecured credit products. The FCA should also work closely with different sectors to share best practice and develop good quality vulnerability strategies that are consistent and provide good outcomes for consumers.

Q 11: How have changes in regulation, or other changes in the market, affected firm incentives?

CDFIs are non-profit organisations and as such their incentives align with those of their customers; to improve financial resilience.

Q 12: How could changes in the market drive incentives which do not align with customer interests?

As above.

Q 13: Please provide evidence and/or views on the current level of cross-subsidisation between different consumers in the unsecured credit market. What forms of cross-subsidisation are compatible with a healthy credit market?

Credit risk assessment involves identifying the risk of default in different segments of consumers to find characteristics correlated with the risk of default. Individuals perceived as being more risky will usually face constrained access to credit and a higher cost of credit. Where customers have experienced financial difficulty through no fault of their own, or belong to a segment of consumers who are deemed at higher risk of default, it should be considered whether it is fair and socially just that these consumers pay more for credit.

In the interest of fairness and bringing down the cost of the poverty premium, an interesting model could be explored through mainstream banks partnering with the affordable credit sector, as discussed above. By providing a source of low-cost long-term capital to affordable credit providers, they can help to bring down the interest that the sector must charge to its customers to cover costs.

Q 14: Are there any gaps in data or the way information flows in the current market that create problems for consumers or lenders? How might these be addressed?

As discussed in earlier questions, issues around credit reference agencies and credit scoring can negatively impact consumers. It can also negatively impact lenders where credit reference agency data is out-of-date and does not show a holistic picture of a person's financial situation and other debts they hold. Open banking and open finance have the potential to help address these information gaps.

Theme 4 – the impact of Covid-19 and the FCA's response

Q 15: Please provide evidence and/or views on the impact of Covid-19 both now and as you expect it may play out in the future on:

a) The demand for different types of unsecured credit

When the Covid-19 pandemic initially hit and the UK went into its first lockdown, CDFIs' saw a significant reduction in demand for credit. Over the next few months demand for CDFI loans began to increase slowly however applications largely came from consumers who were heavily over-indebted and in precarious financial situations, with limited capability to borrow. This meant that CDFIs were not able to lend to these consumers but continued to provide other support services, including online benefits checkers. Demand has slowly increased through 2020, yet customers still remain cautious and are delaying borrowing past the usual peak times.

As mentioned previously, as individuals are increasingly made redundant and families face income shocks we expect demand for unsecured credit to increase through 2020.

b) The supply of credit, including impacts on sustainability of affordable lending and gaps in provision

Going into the recovery, consumers should have greater access to fair and affordable credit. However, the global pandemic has created a unique operating environment and presented challenges to the CDFI sector. The sector already faced pre-existing challenges around access to low-cost long-term capital for lending and scaling up. In this context the pandemic reduced income and threatened the solvency of some firms.

Measures were quickly put in place to support affordable credit providers England through Fair4All Finance, which launched a Covid-19 Resilience grant fund. Unfortunately, CDFIs in other parts of the country have not been able to access support. For example, in Scotland, a specific Credit Union Loan Fund was created but this was not open to CDFIs. This has meant that CDFIs based outside of England have faced increased pressures on their sustainability.

Research on CDFIs and Credit Unions undertaken by Community Finance Solutions (CFS) at the University of Salford and Carnegie UK Trust in May 2020 found that CDFIs have been particularly negatively affected by the Covid-19 pandemic[18]. Despite this, CDFIs are agile, innovative and flexible. They have used their limited resources throughout the pandemic to pivot their strategies and channel support to some of the must vulnerable consumers in the UK, and with sufficient support we are confident in their ability to not only survive but thrive to meet demand in the months and years ahead.

CDFIs generally cannot lend to heavily indebted customers as the loan would often put them in a worse financial situation than they had previously been in. At the same time, when an over-indebted consumer seeks debt advice, a consolidation product could be an appropriate option for them. CDFIs could work in closer partnership with the debt advice sector to become preferential creditors for individuals requiring debt consolidation products. They could then support the customer to save money and move onto a pathway to financial stability, whilst bearing less risk by being regarded as a preferential creditor. Any debt consolidation product should be designed to give the consumer a holistic package of support.

We also recommend that the Government conducts a full review of the Debt Solutions available to consumers in light of the increased number of people who will likely be accessing them because of Covid-19. At the moment there are barriers to insolvency solutions, such as high fees for bankruptcy.

Q 16: Do you think the impact of Covid-19 presents new or unique challenges for the unsecured credit market, or has it just emphasised or entrenched existing issues?

The Covid-19 pandemic and subsequent lockdowns have and continued to fuel increased financial vulnerability amongst consumers and worsening financial health; exacerbating existing issues around poor financial resilience and general money management issues.

We expect the number of consumers accessing unsecured credit, and particularly sub-prime credit, to increase as people are shut out from the mainstream lending markets (due to issues around the credit reporting of payment deferrals discussed earlier) and lenders become more risk-averse.

Constraining access to credit for consumers who have been impacted by the pandemic, through no fault of their own, will be detrimental for growth. It is vital that consumers are not saddled with high-cost debt from the 'new breed' of high-cost credit providers at this time as this will hamper their recovery and create a drag on the UK's efforts to bounce back from the pandemic.

This presents a new challenge for the affordable credit market in scaling to meet increased demand.

[18] Carnegie UK Trust and Community Finance Solutions, University of Salford (2020) Fear and Loaning: Impact of Covid-19 on Affordable Credit Providers Serving Financially Vulnerable Customers. Available: https://d1ssu070pg2v9i.cloudfront.net/pex/carnegie_uk_trust/2020/08/17120904/Fear-and-Loaning-Impact-of-Covid-19.pdf

Q 17: Do you think any of the measures set out in the FCA's temporary guidance for consumer credit, including those related to credit information and forbearance, or the FCA's wider approach have broader relevance to customers in financial difficulty more generally?

The increased forbearance set out in the FCA's temporary guidance for consumer credit has been welcome in giving consumers a breathing space through this period of intense uncertainty. We hope that once deferral periods end, lenders will continue to offer greater flexibility to their customers and not revert to stringent enforcement of contract terms.

As standard CDFIs act with forbearance and flexibility to respond to the needs of their customers. This is particularly important because of the customer base they serve. We believe it is important that more lenders act with greater forbearance, and welcome the implementation of the Government's Breathing Space scheme and the statutory debt repayment plan.