# Fair4All Finance response to the Woolard Review

**December 2020**

## About Fair4All Finance

Fair4All Finance has been founded to increase the financial wellbeing of people in vulnerable circumstances by increasing access to fair, affordable and appropriate financial products and services.

Our vision is of a society where the long-term financial wellbeing of all people is supported by a fair and accessible financial sector.

Many people on low incomes and with low financial resilience have little access to mainstream financial services, which largely focus on serving those with predictable lives and incomes. We are focused specifically on supporting the development of a scaled and sustainable market to deliver financial products and services that enable people in vulnerable circumstances to absorb shocks, smooth incomes and build resilience.

## Introduction

In this response we focus on unsecured credit that enables customers with low financial resilience to meet their day to day financial needs, manage income shortfalls and deal with unexpected costs. We estimate there are around 11 million people in England who need to be supported with increased access to fair and affordable credit. This figure includes:

- those who are stuck in persistent debt, often to multiple lenders
- those on a stable low income who struggle to cover financial shocks
- those who are precarious or newly precarious as a result of the pandemic, who may be falling into debt or rapidly depleting their savings

The current supply of credit to this market is largely made up of a combination of sub-prime commercial lenders and community finance lenders such as CDFIs and credit unions, with a nominal amount of provision by mainstream banks and financial services providers.

Customers can experience bad outcomes when:

- commercial lenders do not comply with good practice around vulnerability or affordability
- they choose products that they don't understand or are not the best options for their circumstances
- lenders collection practices cause harm to mental health and wider wellbeing
- growth in the supply of fair and affordable credit doesn't match the rate commercial lenders are exiting the market, driving people to unregulated credit or illegal money lending

Our response sets out what needs to change in the unsecured credit market to support the financial wellbeing of people in vulnerable circumstances

- improving bad practice in the sub-prime lending market



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- enabling community finance organisations to scale and compete with commercial firms for customers
- incentivising and supporting banks and financial services providers to fill the market gaps left by high-cost providers exiting, or in current unmet demand

Fair4All Finance welcomes this review and offers its support to the FCA and the financial services industry in changing the market to drive better customer outcomes for those in vulnerable circumstances.

We consent to public disclosure of this response.

## 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:**

a) **who is using unsecured credit, and for what purposes**
b) **how unsecured credit is marketed by firms, and how it is viewed by consumers**
c) **the impact of big data and digital technology in this market Please give a breakdown by product where possible.**

We see that the credit market is driven by a combination of consumer demand, product supply and outside forces such as regulation and third-party intermediaries.

This year, more customers in key vulnerability segments are using credit. While borrowing has reduced overall, driven by those who have been resilient financially during the crisis, it does not tell the whole story. There are a large group of people who have had to resort to credit to manage everyday costs, such as food and essential bills. StepChange estimates that a personal debt crisis is emerging, with the number of people affected by coronavirus in severe problem debt almost doubling since the beginning of the outbreak to 1.2 million people[1]. In this environment of increased demand, the importance of a well-functioning market is even greater.

The non-mainstream commercial lenders have significant resources to put into marketing that make it difficult for not-for-profit lenders to compete. There is also evidence to suggest that some marketing practices encourage more detrimental forms of borrowing.

- We have seen evidence of some parts of the unsecured market advertising to customers during daytime television and late at night, taking advantage of consumers who are out of work and could be persuaded to engage in patterns of spending which could be detrimental to their wellbeing
- This is also the case with buy now pay later deferred payment or credit schemes offered at the point of purchase without restriction. For a retailer, this may increase sales, but the practice encourages impulse buying and may push consumers further from financial wellbeing
- In addition, the most prevalent credit options on internet advertising tend to be those who are higher cost, and these are offered to customers without any potential warning of consumer harm

We would suggest that good credit decisions are made based on need identified by a consumer, rather than need shown to them by a retailer. We have learnt from community finance organisations that a conversation at the point of credit agreement can improve customer behaviour in relation to that product, resulting in increased wellbeing. Current advertising practices facilitate an impulsive, unhealthy relationship with a credit product from the outset.

[1] Tackling the coronavirus personal debt crisis, StepChange, 2020

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

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

Customers will increasingly need credit for essential purchases and to meet unexpected expenditure in a challenging economic environment. This will result in innovation in the supply of credit. After the last financial crisis this innovation included an increase in the payday lending market which created harm for customers in some instances.

Anticipating these changes early will help to head off detrimental changes to the market before they arrive. Fair4All Finance believes that this should include supply facilitated through mainstream financial institutions, as larger financial services organisations have the resources to ensure that customer demand is better met and that therefore demand is not there for harmful practices to grow.

The unsecured credit market is still dealing with the ramifications of the affordability assessment breaches carried out by payday lenders in recent years. Thousands of customers were lent to irresponsibly and are only recently able to get redress. However by this point significant consumer harm had already taken place and the mass of complaints meant many people were not able to receive compensation owed to them. The issue is further compounded by claims management companies, who generate significant numbers of affordability complaints which influences the focus on FOS investigations and results in distortions to the market.

We encourage the FCA to be proactive in its regulation to ensure this kind of customer harm and market collapse does not happen again, as it is threatening to do in the guarantor lending market.

Another worrying trend we have observed in the market is unscrupulous IVA lead generators encouraging struggling people to take debt solutions that are not in their best interests. These advertise in a similar way to high-cost lenders, outspending and outcompeting debt advice agencies to buy up space on Google AdWords. This means that people searching for unbiased free debt advice first encounter a list of for-profit options, sometimes posing as established debt charities, which have a commercial incentive to offer a particular solution which may cause long-term harm to a consumer's financial position.

**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?**

The main driver of demand for the smaller value, shorter-term credit we are focused on is low financial resilience. People with little savings, or with low or irregular incomes are not able to meet the costs that life throws at them – running short for shopping before the end of the month or needing to fix a broken boiler.

Research by StepChange supports this, suggesting that the main reasons people use high-cost credit are to pay for everyday food shopping, housing cost and essential bills like fuel and water. A smaller but significant proportion use high-cost credit for repairing broken household items or special one-off events like birthdays or Christmas[2]. The key peaks in demand that we see with community lenders coincide with school holidays, start of the school year (school uniforms) and Christmas.

The coronavirus crisis is having a profound impact on people's financial resilience. While overall saving levels have gone up, many people are accessing savings to meet everyday costs. And this is disproportionately affecting those who already had lower financial resilience – half of people with less than

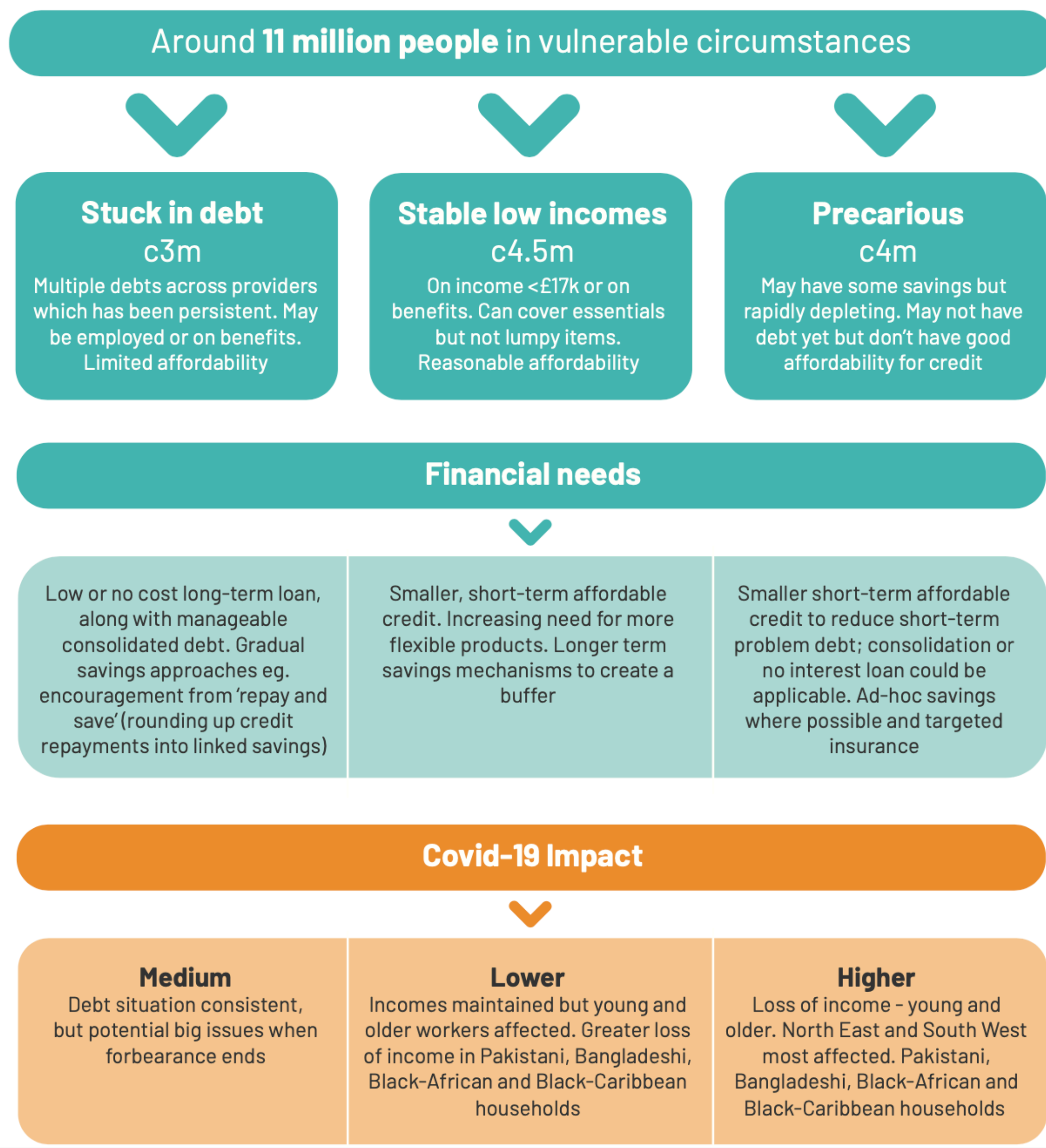
[2] The high cost of credit, StepChange, 2017

£1,000 in savings drew down on them, compared to just 1 in 5 of those with financial reserves of over £20,000.

The pandemic's pressures on people's financial resilience is likely to lead to a greater demand for credit, particularly for food and essential bills – something we are already seeing in our partner organisations in the community finance sector (see responses to Theme 4).

**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?**

We have identified three groups of people who currently have limited access to credit, and who we're focussing our strategy on:



We estimate these groups make up around 11m people, factoring in increases due to coronavirus. These consumers are likely excluded from mainstream sources of credit. They may be able to access credit from alternative sources such as the community finance sector and high-cost lenders, but may be limited by affordability concerns or pre-existing debts.

Research undertaken prior to the pandemic also estimated there to be 5.8m people who have little or no credit history or identity information available in the credit referencing system, meaning they will have limited access to formal credit options[3]. This population includes young people who have not established a credit record, older people who have paid off or never relied on credit, unbanked people, recent immigrants and those who rely mostly on cash transactions.

**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?**

Proper affordability assessment is crucial to a healthy credit market. If someone cannot be expected to have the income to repay a loan, especially if they are already in debt or financial difficulties, it is not responsible to offer them further credit.

But credit is a vital tool that supports people's financial resilience, and currently too many people are excluded from access to fair and affordable credit that is appropriate to their needs. Without this access, we risk pushing people towards harmful alternatives, such as illegal money lending. The latest data from the Illegal Money Lending team shows that 70% of those who borrow from a loan shark have borrowings elsewhere and that on average their outstanding debt is £13,000.

There must be a suite of options available for people attempting to access credit. Our responses to Theme 2 set out how we are supporting the community finance provider sector to scale, and where we see the role of commercial lenders in the market.

We are working with partners to develop a no-interest loan scheme (NILS) pilot, which if more widely rolled out could potentially expand the benefits of credit access to over 500,000 people who would struggle to pay anything more than the principal of a loan. We are also exploring the development of a low-cost consolidation loan product for customers with unmanageable debts across multiple providers, the need for which has increased during the Covid-19 crisis.

For people who cannot afford any form of credit, there should be better integration of lenders with debt advice, income maximisation and other services to support people in financial difficulty who attempt to access credit. The FCA should consider how it can facilitate improved collaboration in this area.

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

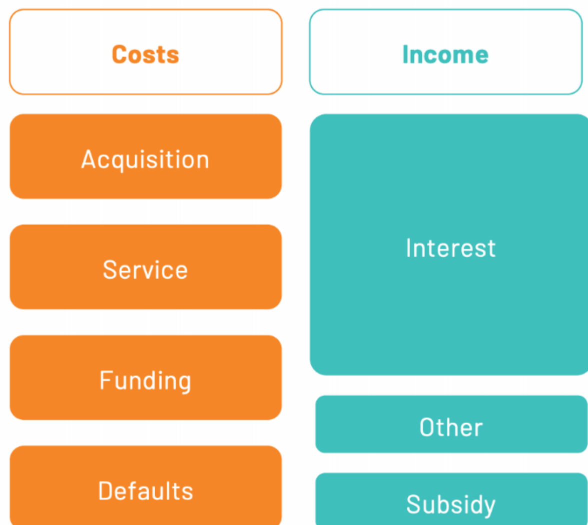
[3] Making the Invisible Visible, Experian, 2018

The supply of unsecured credit is changing significantly, notably in the non-standard credit market with the collapse of large payday and rent-to-own lenders. The costs of compensation for affordability complaints is causing some lenders to leave this market and others to tighten lending criteria.

Changes in customer profile caused by the coronavirus crisis are challenging the sustainability of lenders. Experiences of our partner organisations in the community finance sector suggest an increase in demand from consumers who cannot responsibly be lent to, due to a lack of affordability. At the same time, there are many people who have maintained their incomes while also reducing spending as a result of the pandemic (around 1 in 5 according to the Resolution Foundation[4]). While this is a positive development, meaning that more people can pay down debts and build savings, a reduction in demand for credit from those who can borrow affordably and sustainably will challenge lenders' business models.

Our focus is on credit as a tool to support people with low financial resilience to cope with income shocks, flex tight budgets or make essential purchases. This is necessarily a more challenging market to serve sustainably. Community finance providers that aim to support good customer outcomes need to consider fair interest rates, flexible forbearance policies and tailored customer support, which can decrease income and increase costs.

The following diagram indicates the basic unit economics for the lending. To achieve a sustainable business, providers need scale – and there are trade offs: the acquisition of customers with more face to face interaction increases up-front costs and yet correlates with much lower default rates than pure online models. On the other hand, commercial lenders who have tried to increase profits via high interest rates, or cut costs in affordability assessments and customer support, can see their model struggle with bad debt provision or complaint fines.




There are particular dynamics in the community finance sector to consider

- Providers must balance pressures of increased costs to serve and reduced incomes during this difficult year. For community finance providers this is particularly challenging given these organisations typically operate with very thin margins on individual loans
- Gaining scale requires effective marketing, systems/processes and funding. The current market operation creates a significant barrier for small community providers in raising awareness and attracting customers

[4] Caught in a (Covid) tra*p*, Resolution Foundation, 2020

In order to support the community finance sector, more should be done to reduce costs through cheaper funding lines and a more balanced acquisition environment, where the not-for-profit lenders currently struggle to compete with high-cost providers.

Regarding developing business models in the community finance sector, for a long time credit unions have utilised payroll lending to facilitate easy repayment of loans and reduce default rates. More recently, some credit unions have linked loans to benefit payments, which are paid into a credit union account. Similar to payroll lending, this allows the credit union to take repayments directly from the benefit payment, reducing the incidence of default. As a result, the lender can offer credit at a more affordable price.

Repayments made through Universal Credit and Child Benefit can enable community finance lenders to increase repayments in a way that is manageable for customers. The principle of linking repayments to income can help address affordability issues worsened by the coronavirus crisis. Mechanisms like this put the customer first – as in student loan repayments – ensuring that when incomes fall the customer is more protected financially.

We will be conducting research on how exactly these business models impact consumers. We believe they have the potential to reduce costs and ease the repayment process for borrowers, but care should be given that behavioural biases towards defaults don't lead to borrowers prioritising consumer credit debts over more essential commitments.

**APR and interest cost**

Fair4All Finance's work with responsible lenders has led us to believe that APR is not a useful representation of cost of short-term credit for customers. It can lead to confusion and can distort perception of certain parts of the market.

While we agree that for larger loans over a very long term, such as mortgages, APR is useful, we believe that for smaller loans over 6-18 months, total interest cost is a more transparent representation of the cost of credit.

Moving to an interest cost representation would improve customer awareness of the true financial differences between credit options and would mean that the interest rate is not hidden by the term, as is sometimes the case in the market.

The table below illustrates some of the difficulties with using APR, where it particularly distorts total cost for very short-term products. The final column is a useful basis for comparison across the short-term products

| Type of loan | Amount | Term | Total interest cost | APR | Interest cost per £100 |
|---|---|---|---|---|---|
| From a friend in a pub | £25 | 1 week | £2 | 5370% | £8 |
| Short term payday loan | £500 | 6 months | £500 | 1,355% | £100 |
| Credit union loan | £500 | 6 months | £54 | 42.6% | £11 |
| CDFI | £500 | 6 months | £140 | 169% | £28 |



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| Mortgage | £100,000 | 25 years | £102,563 | 6.5% | £102 |
|---|---|---|---|---|---|

**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?**

Our broad view is that all forms of credit and credit-like products should be regulated. Proper regulation ought to ensure that information is presented transparently to customers, affordability is fully assessed, and forbearance and collections are handled sensitively. It is important that the commitments made under such arrangements are included in data made available to providers doing affordability checks for credit.

The growth of Employment Salary Advance Schemes (ESAS) and Buy Now Pay Later (BNPL) arrangements has the potential to offer more affordable alternatives to high-cost lending and we're pleased the FCA wants to better understand the risks and benefits of these products.

Potential issues associated with BNPL arrangements that the FCA should consider include

- Business models that are based on commission from retailers can reduce costs for borrowers but are premised on increasing the amounts spent by customers. Some firms have explicitly marketed their product to retailers on these grounds. A recent survey suggested that most younger users of BNPL believe it has made them spend more than they would otherwise, and around half have missed a payment[5]. The FCA should review the extent to which these products are driving people to overspend and take on debt they cannot afford
- Many retailers have BNPL as the default payment option. This exploits behavioural bias towards inertia and increases the risk that customers will take on unwanted or unaffordable debt
- Transactions are not recorded on credit files, which can hinder the ability of other lenders to conduct affordability assessments and may lead to consumers taking on too much debt
- Some BNPL schemes charge expensive and untransparent late fees
- As they are unregulated, BNPL firms do not have the same requirements around what information they must share so consumers may not be aware of all the risks involved with accessing credit

Regarding ESAS, the FCA should consider

- Affordability is currently assessed only on the basis of the employee's salary. Other spending commitments, which could include existing debts or priority payments such as rent or council tax, are not taken into account
- Repayments taken directly at source from a salary can take precedence over essential and priority debts. ESAS providers should take care that employees understand that their salary deductions should not come before other more important commitments
- ESAS transactions are not recorded on credit files, which can hinder the ability of other lenders to conduct affordability assessments and may lead to consumers taking on too much debt
- Employees who draw down on their salary are more likely to find themselves short before the end of the next pay cycle and may enter a cycle of repeat advances

[5] A UK Survey of Consumer Attitudes to BNPL, Capco, 2020

- ESAS using flat fees can be a cheap way for employees to smooth incomes and manage lumpy expenditure, but costs can stack significantly if multiple transactions are made
- The FCA has identified a lack of transparency over cost as a potential risk of ESAS, as they are not required to use APR. As outlined above, we do not believe consumers will find it more helpful or transparent to see an annualised rate for what is potentially such a short-term, low-value advance (eg £1 fee for one week's advance of £100), rather than a flat fee

In both cases, the FCA could do more to understand the real impact of these products on consumers. More analysis should be undertaken to assess how customers are using products and what harms they may be facing. To help ensure these products help customers, the FCA should seek to bring them within its regulatory perimeter.

In addition, we are increasingly concerned that a reduction in high-cost credit provision will lead to a surge in illegal money lending via both face to face and online channels, which may be difficult for customers to distinguish from regulated lenders.

We think that developments in illegal money lending practice should be monitored more closely and would be interested in approaches where firms are given incentives to ensure that their customers do not become prey to illegal money lenders.

**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**

We estimate as many as 5 million people in England are currently unserved by the credit market. As described above, high-cost lenders are re-trenching and all credit providers will increasingly struggle to serve customers made more precarious by the coronavirus crisis. Without intervention, millions could be excluded from access to credit, denied a vital tool for smoothing incomes, buying essential items and weathering life shocks. Alternatively, they may be driven to informal borrowing from family and friends, or even to harmful illegal money lending.

We are working to address this gap in supply through our Affordable Credit Scale-up Programme, which aims to grow the community finance sector so that more people than ever have access to a fair and affordable credit option through CDFIs and credit unions. Our Covid-19 Resilience Fund has supported the sector through the pandemic (see Theme 4 below), helping to preserve around 50% of lending capacity targeted at people in vulnerable circumstances. With these programmes we intend to grow the value of community finance provision to these customers from around £300m to £850m a year.

Additionally, we are working with HM Treasury, Toynbee Hall and Fair By Design to develop a no-interest loan scheme (NILS) pilot, to provide a financial lifeline to customers who would struggle to pay anything more than the principal of a loan. This could support over 500,000 customers with a new credit option if fully realised past the pilot stage.

We are also exploring the opportunity for a partnership with a white goods retailer that could offer essential household items such as fridge freezers and washing machines on a low-cost finance or rental basis at a substantial scale, tackling appliance poverty and addressing another gap in the supply of credit/credit-like provision.

The FCA has a crucial role to play in promoting growth in the community finance sector and addressing gaps in the supply of credit. We are supportive of the FCA's approach to the sector, which recognises its

distinctive value, and the FCA should continue to make appropriate regulatory adjustments and exemptions for credit unions and CDFIs. Additionally, the FCA should consider

- Looking at a long-term and sustainable funding model that supports an expanded community finance sector
- Further work to increase consumer awareness and demand for community finance providers. Following its approach to RSLs, the FCA should consider issuing new rules or clarifying guidance to enable better signposting to community finance by other organisations, including by mainstream lenders
- Addressing the imbalance in marketing between the community finance sector and commercial lenders, who currently outspend and outcompete community lenders. The FCA should also consider limitations on advertising of more harmful forms of credit, in line with the approach taken with gambling advertising

However, meeting the demand for fair and affordable credit will be impossible without change in mainstream and high-cost commercial lending.

The mainstream financial services sector has made a hugely positive contribution during the pandemic through supporting payment holiday and interest free overdrafts. We believe banks and financial services providers also have the potential to make the biggest positive impact in addressing the gaps in the supply of credit for people in financially vulnerable circumstances. Mainstream providers account for over £200bn of outstanding consumer credit, yet they currently have limited engagement in these parts of the market.

To address growing gaps in credit supply, we think there are gaps equivalent to £2.6bn which we believe could be filled through bank-supported lending to these customer cohorts. Our Affordable Credit Scale-up Programme has demonstrated that it is possible to sustainably serve people in financially vulnerable circumstances, and we will work with banks to help them explore this opportunity. The FCA should explore what would support banks to enter this market, including looking at the regulatory barriers that increase the costs of serving these customers for banks and considering potential constraints around their capital requirements.

The "sub-prime" and high-cost credit sector currently serves 3 million people. Though many customers experience harmful outcomes from these products, and significant providers are leaving the market, it has the potential to play a role in a future, healthier credit market. We believe that more can be done to change the high-cost credit sector so that it follows the best practice set by the community finance sector. The FCA should take this review as an opportunity to address regulation of high-cost credit so that customers can expect similar outcomes across different consumer credit providers.

## Theme 3 – The role of regulation in unsecured credit markets

**Q10: Do you think current regulation drives similar outcomes for consumers who use similar or substitutable unsecured credit products?**

No, we observe significant differences in outcomes between lenders offering similar products. For example, community finance providers and high-cost lenders both offer relatively small sum short-term unsecured lending, and often serve similar populations, yet record very different customer outcomes and experiences.

A report into Fair for You estimated that the affordable lender had generated a social impact of over £50m since starting its operations in 2015. It identified over twenty different benefits and outcomes reduced living costs, healthier diets and improved mental health. Customers also reported Fair for You for understanding their difficult circumstances and treating them with respect.

In contrast, customers who had borrowed from high cost credit sources in the 12 months prior to using Fair for You reported a huge range of problems, including stress and anxiety about money, cutting back on food and other essentials and struggling to pay household bills. Many said that they had felt intimidated and harassed by their previous lenders.

The FCA needs to promote and help embed examples of best practices to ensure better customer outcomes across all providers. The FCA should consider how current regulation allows for such different outcomes, and whether a more robust or prescriptive approach needs to be taken to drive up standards.

**Q11: How have changes in regulation, or other changes in the market, affected firm incentives?**

The high-cost short-term credit price cap has been a positive change to the market and we encourage such proactive action to prevent customer harm. It is important to also consider the potential unintended consequences of such changes, for example the harmful behaviour on affordability checking could have been driven by this change, as the reduced income from interest drove a need for high sales volumes. Loans becoming less profitable due to the cap could have also incentivised relending, as lenders needed to double down on existing customers.

To counter these unintended consequences, we would encourage proactive monitoring of those organisations particularly in the high-cost credit space, where there appears to be internal incentive to prioritise income or profit over customer outcomes.

**Q12: How could changes in the market drive incentives which do not align with consumer interests?**

Overall, it is important that developments which remove the supply of credit for particular parts of the market are balanced with concrete programmes which increase supply from other sources – such as mainstream lenders being part of the solution for replacing exiting high-cost credit providers.

With increased pressure on incomes, those who most need credit are finding it more difficult to get access due to their lack of affordability. These cases could open up opportunities for irresponsible or exploitative forms of lending which result in customer harm.

Care should be taken that the impact of coronavirus on people's finances – where a minority of people are saving and cutting down on debt and credit, and another minority need credit but have less affordability – doesn't incentivise firms to exploit customers on lower incomes to make up for better off customers leaving the credit market.

**Q13: 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?**

Cross-subsidisation can be part of a well-functioning credit market. It is important that as many customers as possible are able to access appropriate credit, so to do that the costs of that servicing must be borne somewhere. Cross-subsidy can enable firms to serve customers in more vulnerable circumstances and can enable them to handle customers in a supportive way if they do default. Access to the credit market benefits from this risk sharing, and it should be encouraged to the extent that those who are better able to repay subsidise those who might be less financially well-off.

We see examples of healthy cross-subsidisation in parts of the community finance sector, where larger loans to more well-off borrowers cross-subsidise urgent smaller loans to customers on low incomes. This is notable among credit unions, some of which offer large personal loans or even mortgages and whose interest cap limits the profitability of smaller short-term loans.

Unfortunately, sometimes the reverse is true, where firms make profits on the less well-off customers with less stable finances. The FCA identified examples of this in its review of relending practices by high-cost lenders. Relending over and over to the same customers often increases debt and distress but was part of the core business model of some firms. This sort of cross-subsidisation, where business models rely on people getting into financial difficulty or becoming overburdened with debt is not compatible with a healthy credit market.

Many commercial financial services providers have completely vacated the market of serving customers with low financial resilience. Some banks see vulnerability simply as a risk to be managed, rather than a customer group who they as essential services providers should seek to serve.

This means that community finance providers like CDFIs have to be set up exclusively to serve people with the lowest financial resilience. As outlined elsewhere in this response, this is an intrinsically expensive market to serve. Customers who are willing to repay may still be forced to default due to the difficult financial circumstances they find themselves in. Other customers on the CDFI's loan books have to cover these costs, which are reflected in the relatively high cost of credit.

The costs of default are therefore not being distributed across the whole of the unsecured credit market, but are being concentrated on the least resilient, ie community finance provider customers. This amounts to a kind of a poverty premium that should not be a feature of a healthy credit market.

**Q14: Are there gaps in data or the way information flows in the current market that create problems for consumers or lenders? How might these be addressed?**

We believe firms should do more to share research, data and best practice on how they serve customers in vulnerable customers, rather than firms having to reinvent the wheel around their vulnerability strategies. This would raise general standards across the sector and reduce the administrative burden of individual firms developing and implementing measures separately. The FCA should consider how it can best facilitate this.

We also recommend that the FCA promotes greater transparency around customer data by firms, including demographics and the numbers of customers in individual firms with particular types of vulnerabilities. Following this, firms should publish information on the interventions taken for different customer groups. This transparency would enable peer accountability of the treatment of customers in vulnerable circumstances and the strengthening of internal cultures within firms of serving vulnerable customers.

We will be responding in more detail to the FCA's credit information market study, as there are numerous issues with gaps in data and with the flow of information in that market.

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

**Q15: 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**
b. **the supply of credit, including impacts on sustainability of affordable lending and gaps in provision**

Many people who have seen their incomes fall or savings dwindle as a result of the pandemic are turning to borrowing to make ends meet. According to the Resolution Foundation, more than four in ten adults have

used at least one form of borrowing to meet everyday living costs, rising to over half of those on the lowest incomes[6].

StepChange have reported on a growing coronavirus personal debt crisis, estimating that those who have fallen into arrears or borrowed to make ends meet as a result of the pandemic have amassed £10.3bn in debt. Additionally, the number of people affected by coronavirus in severe problem debt has almost doubled since the beginning of the outbreak to 1.2 million people[7].

This situation has led to challenges for the unsecured credit market, which has had to bear the costs of increased forbearances measures and has seen increased defaults and bad debt. Changes in customer demand will also have an impact on the sustainability of credit provision. Going forward, much of the demand for credit may be driven by those who do not have the affordability to borrow. At the same time, overall borrowing has reduced, as many people have been able to reduce spending over the course of the pandemic – since the beginning of March, households have repaid over £15bn of consumer credit[8].

These trends have been reflected in the experiences of our partner organisations in the community finance sector. In the earlier stages of the pandemic, the community finance sector saw a fall in demand for a credit, both in terms of the number of people seeking loans and the size of loans being sought. A survey of community lenders undertaken by Carnegie UK Trust and the University of Salford in May found a fall in lending of 70% year-on-year[9]. This reflected the experiences of our partner organisations in the sector.

However, from June and July onwards we have seen demand among our partners pick up again. While lending has been down overall, it is notable that lending to customers in vulnerable circumstances reduced by far less, and in many cases increased. Partners report that more customers have been borrowing to put food on the table, buy essential household items or to bridge the gap between losing employment income and receiving their first benefit payments.

However, many community finance providers we work with are seeing more demand, but not necessarily more lending, as there are more people are seeking credit who cannot afford it.

The community finance sector has faced significant challenges to its sustainability as a result of the pandemic. Lenders saw significant falls in income due to the initial drop off in lending and faced costs associated with increased forbearance requests. There were operational costs associated with transitioning to remote services, particularly for lenders whose business models had particularly relied on face-to-face lending.

In response, Fair4All Finance established a £5m Covid-19 Resilience Fund to ensure that the sector can emerge from the crisis in a resilient position and capable of future growth. We provided financial support to help organisations manage the impact of lost income and additional forbearance costs, along with funding for technical support needed to adapt models to serve customers during this period.

We have committed £3.6m to 28 organisations, as of September 2020. These organisations collectively lent over £129m in the last year and serve 130,000 customers, meaning that this intervention has helped preserve around 50% of lending capacity targeted at people in vulnerable circumstances in the community finance sector. The majority of organisations report that they have preserved or increased their lending capacity due to the support.

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[6] Caught in a (Covid) trap, Resolution Foundation, 2020
[7] Tackling the coronavirus personal debt crisis, StepChange, 2020
[8] Money and Credit statistics - October 2020, Bank of England, 2020
[9] Fear and Loaning – The Impact of Covid-19 on affordable credit providers serving financially vulnerable customers, Carnegie UK Trust and the University of Salford, 2020

However, the financial impact of Covid-19 on the community finance sector has been significant. While this support has increased organisational resilience, further financial and non-financial support may be needed, particularly if the economic downturn is long-lasting.

**Q16: 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 impacts of Covid-19, as outlined above, have been far-reaching and have created an environment that is difficult to lend in. Some existing issues, such as where liquidity is stretched and cross-subsidy in business models is insufficient, have been exacerbated by the Covid-19 crisis.

But the unique challenges of Covid-19 will require innovation and new approaches to serving customers to ensure that they have credit when they need it and that this is credit that they can afford to repay.

Firms have played an incredibly important role in making sure that customers have been supported through this year. In response to the crisis, 4.4 million payment deferrals were granted across mortgages, credit cards and personal loans since the start of the pandemic. In addition, over 27 million personal current accounts have had an interest-free buffer applied to their arranged overdraft. In the challenging economic environment that will follow in the wake of the pandemic, firms should consider how these measures could be a platform extended beyond the current crisis.

In the community finance sector, the pandemic clearly presented unique challenges – an estimated 70% drop in lending, the need to cease face-to-face lending (often a more important part of business models and customer support services in this sector than in others) and an unprecedented increase in forbearance requests.

However, it also emphasised existing issues, for example around technology, which the sector often has not had the resources or capability to properly invest in – this compounded the challenges of working and serving customers remotely. The pandemic also particularly tested lenders whose business models were already run on very tight margins and that struggled with sustainability.

**Q17: 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 FCA's strong emphasis on forbearance was welcome, and it recognised the unique challenges of Covid-19. Parts of the FCA's temporary guidance were more prescriptive than its usual guidance on forbearance, for example, it was explicit that firms should prevent customers' balances increasing while they're in financial difficulty, by waiving or suspending interest, fees and charges. This will have led to more common consumer outcomes between different financial services providers – the FCA may want to consider how a more prescriptive approach could better support consumers.

It should be noted that the community finance sector incurred significant costs associated with increased forbearance measures. These were necessary to prevent serious financial harm to customers and Fair4All Finance was able to support much of this cost through it's Covid-19 Resilience Fund. However, the FCA should consider the financial impact on providers of the various additional forbearance measures, in order to determine which measures could sustainably be applied in the FCA's wider approach.