Future Regulatory Framework Review
Fair4All Finance response

February 2022

Introduction

We are supportive of HM Treasury's proposals to create a financial services regulatory framework that is fit for the future, and that delivers stability, protection and innovation for consumers.

We agree that the best way to deliver these outcomes is to build on the FSMA model, where expert, operationally independent regulators are responsible for designing and implementing regulation within a framework set by government and parliament, with scrutiny and oversight from parliament, HM Treasury and stakeholders.

Given Fair4All Finance's remit we have focused our response on how the future regulatory framework can better support a sustainable market for the provision of fair financial products and services for customers in vulnerable circumstances.

Our response:

- provides evidence on the scale of financial exclusion and market failure in the UK
- proposes that the FCA is given a statutory responsibility for financial inclusion to ensure that a sustainable market operates to serve everyone, including customers with low incomes or low financial resilience
- sets out how financial inclusion can contribute to levelling up growth and productivity across the UK
- supports proposals to strengthen the role of statutory panels, and to improve their transparency and diversity - but calls for a stronger consumer voice in the policymaking process, particularly from people in vulnerable circumstances

About Fair4All Finance

Fair4All Finance is a not for profit organisation founded in early 2019 to improve the financial wellbeing of people in vulnerable circumstances by increasing access to fair, affordable and appropriate financial products and services. We have three main priority areas:

- Expanding provision of affordable credit initially through a scaled community finance sector
- Partnering with banks and financial services providers to support the delivery of products and services for customers in vulnerable circumstances
- New product and market development – catalysing change by developing and scaling products and services to address market gaps

You can find our full strategy here.

Our response

Under the current regulatory framework, the government and the FCA have taken significant steps to support the financial inclusion of people in vulnerable circumstances. Examples include the introduction of basic bank accounts, recent moves to legislate to protect access to cash, and the FCA's introduction of guidance on the treatment of customers in vulnerable circumstances.

However, there is evidence that despite these positive measures, the market is failing to serve people with low financial resilience:

- 1 in 4 households in the UK have no insurance at all
- One in five adults has less than £100 in savings
- 5.8m people are 'invisible' to the credit referencing system

Looking at consumer credit in particular, there has been a huge contraction of provision in the 'subprime' lending market:

- In the home collected credit market, customers numbers decreased by 54% across the three main doorstep lenders from 2016-2020. Once the largest lender, Provident, has fully withdrawn from the market this will reach a reduction of 80%[1]
- The volume of lending by high-cost short-term or payday lenders has also plummeted, from almost 5m loans in 2018 to around 700k in 2020[2]. This market has seen a number of high-profile exits by the former largest players and is unlikely to lend at the same scale again

This market has caused a lot of financial harm to consumers over the years and many people will cheer to see it shrink in

[1] Provident Financial Group, Morses Club, Non-Standard Finance Annual Reports and presentations
[2] FCA Product Sales Data supplied to Fair4All Finance

this way. But households will still need credit to smooth their incomes, meet unexpected costs and make essential purchases. And it's not clear what's going to fill this gap. Overall, we estimate around 11m people struggle to access affordable credit.

It's people on the lowest incomes who have most needed to access credit during the pandemic. Over half of households in the lowest income quintile were reliant on additional borrowing or support for everyday living cost during the pandemic, compared to less than a third of highest income households[3].

Fair4All Finance is working to address these market gaps through our Affordable Credit Scale Up Programme and prove a sustainable alternative model to high-cost credit. The programme has focused on giving tailored support, investment and grant funding to drive the growth of community finance providers, such as credit unions and community development finance institutions (CDFIs). However, the sector doesn't have the scale needed to address the gap alone. We estimate that community lenders provide around £250m in annual lending targeted at customers in vulnerable circumstances – a fraction of the high-cost credit market.

Mainstream banks do not offer the affordable unsecured short-term credit that customers with low financial resilience need as an alternative to high-cost credit. Most bank personal loans start at £1,000 or £2,000 and have terms of over a year, whereas 79% of the customers of the community finance providers we work with need to borrow less than a £1,000. Bank lending criteria can also exclude customers with irregular income or thin or damaged credit files. Despite calls in the Woolard Review last year for banks to offer or fund more alternatives to high-cost credit, there has been little progress from industry.

Where do customers have left to turn? The FCA have recorded substantial growth in the number of people reporting borrowing from family and friends, from 3.6m in 2017 to 5.9m in 2020. This will work well for many people, but as one customer told us during our research into credit use among social housing tenants, 'You can borrow from friends and family only so many times and then you are stuck'[4].

And while the majority of this lending will be benign, it is important to note that the England Illegal Moneylending Team routinely report that many victims of loan sharks believe they are borrowing from family and friends. The most recent study on the scale of illegal moneylending dates from 2010 and estimated that there were 310,000 victims of loan sharks[5]. We are concerned about the direction this illegal market may be heading in and are launching new research on the scale of illegal moneylending in the UK.

The challenges facing people in vulnerable circumstances will continue to grow as the cost of living crisis intensifies. According to the Resolution Foundation, families will face a typical income hit of around £1,200 a year from April 2022 as a result of tax rises and soaring energy bills that disproportionately hit low income households[6]. Just as has happened over the pandemic, it will be the lowest income households who most need access to a fair and affordable way to flex their income and spending as the crisis deepens.

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[3] Resolution Foundation (2021), Pandemic Pressures
[4] Fair4All Finance (2021), Unlocking Tenant Financial Resilience
[5] Policis (2010), Interim evaluation of the national illegal money lending projects
[6] Resolution Foundation (2021) Labour Market Outlook Q4 2021

Creating a financially inclusive market

What's happening in the consumer credit market reflects a broader trend in financial services towards a personalisation of risk. Rather than serving all their customers and pooling the resulting risks and rewards, firms are pricing out customers who are seen as riskier or less profitable. In the insurance market in particular, more granular risk-based pricing has led to a significant poverty premium for people on low incomes[7].

Firms cannot exclude customers based on protected characteristics. The FCA's strong leadership on vulnerability means that customers who have vulnerabilities and are included in the market can now expect much better treatment from firms. But there is nothing to stop firms, including large mainstream financial services providers, from simply pricing out or excluding people with low incomes or low financial resilience.

Left to its own devices, the market will continue to exclude customers who need access to fair financial products. We therefore want to see a regulatory framework that supports a sustainable market for serving customers with low financial resilience and puts financial inclusion at the core of firms' responsibilities.

While there has been strong leadership from the government on issues relating to financial inclusion, we believe that introducing a cross-cutting responsibility for the FCA to have regard to financial inclusion will ensure that this issue is future-proofed and factored into all of the regulator's activities over the long-term.

It's important to build this into the new regulatory framework so that the risks of unintentionally excluding more people are factored into all new measures taken by government and regulators. We believe the extent of financial exclusion in the market indicates the limitations of the regulators' current objectives. The FCA has made important interventions in the consumer credit market in recent years in support of its consumer protection objective that have prevented harm to people in vulnerable circumstances. But as set out above, this has inadvertently led to a collapse in the provision of credit for customers with low financial resilience.

Looking ahead, the FCA is introducing a new consumer duty that will raise standards of treatment that customers can expect from financial services. The FCA accept this may lead to some products that don't work well for consumers being withdrawn from the market. We support this measure to raise standards and protect consumers from harm - but it's not clear what will take the place of products that are withdrawn.

The FCA's strategic objective is to ensure that the market functions well. As we design a new regulatory framework for financial services, we would like to see a statutory recognition that a market where millions of people are locked out cannot be seen to be functioning well.

[7] https://fairbydesign.com/insurance-poverty-premium/

Financial inclusion, growth and levelling up

The proposed regulatory framework aims to foster a respected and internationally competitive financial services sector that is an engine of sustainable growth.

International competitiveness was not an objective of the FSA but was one of seven principles of good regulation or 'have regards' of the former regulator. This was identified by government and parliament as contributing to the regulatory failure of the financial crisis, as an 'excessive concern for competitiveness' led to a generalised acceptance of 'light-touch' regulation[8]. Therefore we agree that any new objectives around growth and international competitiveness should be secondary to the FCA's core objectives around market integrity and consumer protection.

We believe that a stable and inclusive financial services system with financially resilient customers will be huge driver of growth across the UK. We're pleased that the government has recognised the role of financial inclusion in the levelling up agenda and has appointed the CEO of Fair4All Finance to sit on the Levelling Up Advisory Council.

Financial exclusion and low financial resilience are key barriers to opportunity. Without access to fair and affordable financial services, everyday life events or financial shocks can tip people into financial vulnerability, force them to turn to high-cost credit or trap them in long-term debt. The resulting negative impacts on health and 'scarcity mindset' hinders people's ability to properly participate in society, as well as their productivity:

- It's been estimated that poor financial wellbeing costs UK private sector employers £1.56bn each year, as money worries reduce people's productivity at work and leads to 4.2m missed days of work[9]
- A 2014 study found that the social cost of problem debt experienced by 2.9 million people amounted to £8.3 billion. This included costs of £2.3 billion resulting from stress, anxiety and other factors undermining people's productivity at work, prolonging unemployment and leading to people losing their job[10]

Boosting productivity and tackling the productivity gap between different UK regions is identified as one of the key focus areas of levelling up, and considering international competitiveness, productivity is also an area where the UK lags behind almost all comparable countries[11].

We've seen the wider economic and societal benefits that come from allowing people to access fair financial products. For example, an independent report into the social impact of one of our investees, Fair for You, showed how they have generated over £50m of social value since 2015, saved over £2m from reduced use of NHS services and helped move over 70% of their customers away from high-cost credit. Among the other positive impacts reported by customers were healthier diets, improved mental health and improved self-esteem[12].

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[8] HM Treasury (2010), A new approach to financial regulation: judgement, focus and stability
[9] Centre for Economics and Business Research (2018), Financial wellbeing and productivity: A study into the financial wellbeing of UK employees and its impact on productivity
[10] Baker Tilly (2014), Transforming Lives: a review of the social impact of debt advice
[11] Andy Haldane (2018), The UK's Productivity Problem: Hub No Spokes
[12] Centre for Responsible Credit (2020), The Social Impact of Fair For You

Case study of how Fair For You helped one customer improve her situation and support her community

‘It was nice to know there was someone that actually cared about your situation.’ When times were tough previously, Erica (not her real name) had borrowed money from another company who she describes as ‘Absolutely awful, ridiculously expensive. If you had money problems they’d be hounding you, banging on your door - it was frightening.’

She first used Fair for You in 2017 to buy a tumble dryer - her autistic son had a lot of accidents and before this she was forced to dry some clothes with a hairdryer. Erica has since used Fair for You to buy kitchen appliances and a bed for her son, who previously slept in her bed. ‘He loves his new bed - he has actually slept through the night. He seems a lot happier - it's better for him and for us as a family as well.’

Erica remembers that Fair for You were ‘so understanding’ when money problems arose recently, giving her a short payment holiday for no extra charge. ‘It was nice to know that there was someone that actually cared about your situation,’ she says, adding that knowing she can use Fair for You gives a sense of security: ‘If my washing machine was to break or something like that, I know that I have that option,’

Erica was recently able to start her own small business and has become active in her community, setting up a mutual aid group in her neighbourhood to help vulnerable or older residents get food, medicines or other supplies during the Covid-19 outbreak. ‘I feel nice that I'm doing something for somebody else and it's making a difference to people's lives’ she says.

A stronger voice for consumers

We support setting up a regulatory framework that builds on the FSMA model, with regulators responsible for designing and implementing regulation within a framework set by government and parliament. Expert and operationally independent regulators should be able to regulate in a more agile and flexible way and better react to a changing market. It’s important that this greater independence is balanced with proper public oversight and accountability, and the government should ensure that parliament has the time and resource to fulfil this role.

We agree with the government’s view that any policymaking process risks being deficient if it does not draw sufficiently on the views, experience and expertise of those who may be impacted by regulation. However, we believe that under the current system, consumer groups and civil society do not have the resource required to engage as comprehensively as needed with the stakeholder engagement and policymaking process, and cannot match the resources of industry.

Many consumer groups are forced to focus only on particular issues such as credit and debt due to the need to prioritise their limited resources. The government should consider how funding could be ring fenced to ensure that the consumer voice is properly heard throughout the stakeholder engagement and regulatory policymaking process.

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We support proposals to strengthen and improve transparency of the statutory panels. But even factoring in plans to bring two further panels onto a statutory footing, there will still be only one FCA panel representing consumers, and no panel representing the public interest to the PRA. We would like to see measures to ensure that the FCA's consumer panel is given equal weight with the various panels representing industry.

We support the FCA's plans to improve the diversity of the panels, and proposals to increase transparency around the appointment process. It's vital that the panels are properly representative of customers and stakeholders, given the variation in outcomes that people from different groups experience when engaging with financial services. For example, we know that Black African, Black Caribbean and Bangladeshi groups are 4x, 3.5x and 2.5x more likely to be denied a loan respectively compared to White groups, and that 60% of Asian and 63% of Black households have no savings, compared to 33% of White households – issues we are conducting research into.

The consumer panel should also be complemented by a panel of people with personal experience of financial exclusion, poverty or financial vulnerability, to ensure that the consumer voice is properly heard, and that financial services regulation is designed to suit the needs of everyone in society.

Additionally, a greater statutory role for civil society organisations beyond those directly focused on personal finance would help the development of a financial service sector that supports the sustainable growth of the economy in a way that serves society.