The Money Charity Response – FCA Woolard Review into the Unsecured Credit Market (December 2020)

The Money Charity is a financial capability charity whose vision is to empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.[1]

We welcome the opportunity to respond to the Woolard Review into unsecured credit, which we think is timely and should generate useful priorities for future action.

We have organised our thoughts under the four themes of the discussion paper, with our recommendations to the Review placed in **bold type**.

[1] See box on back page.

Theme 1: Drivers and use of credit

As a financial capability charity, we are involved on a daily basis in educating people (school learners and adults) in the nature and uses of unsecured credit, including concepts such as interest rates, what different types of credit look like and what they are, when it is wise to use credit and when not, how to budget, and so on. This helps to inform our view of how the unsecured credit market should work.

There are supply and demand factors involved in the drivers and use of unsecured credit.

On the **supply side**, there are many providers of credit using a variety of business models, types of credit and contact points, including the increasing use of point-of-sale credit and borrowing against pay. We comment on trends in supply under Theme 2 below.

On the **demand side**, people may wish to use credit for a spectrum of reasons from purchasing consumer durables, to dealing with family crises such as bereavements or relationship breakups, to illness, to covering a deficit budget.

The advice we give to people is to be cautious about unsecured credit. Some uses may be wise (such as purchasing a laptop for home learning), while others can lead to a spiral of debt and insolvency. Helping people to understand and avoid the latter is a key part of our work.

Some uses of credit are regrettable but may be unavoidable, for example borrowing money to cope with an unexpected bereavement.

Where people borrow money, they need to have a repayment strategy and plan in mind. Generally, unsecured credit at high interest rates should be thought of as a short-term facility, with the debt paid off reasonably fast. Repeat, roll-over borrowing at high interest rates should be avoided.

For example, we have long argued that the credit card minimum payment is set too low. As we point out each month in our publication *The Money Statistics*, if people repay their credit cards at a constant £ rate rather than at a diminishing rate (as happens under the 1% rule) they can pay off their card dramatically faster and avoid continuous rollover.[2]

We urge the FCA to consider revising the credit card repayment rule along the lines of a higher initial payment followed by a fixed monthly amount. This relatively small and affordable adjustment to the rules could make a big difference to the repayment term for a significant group (around 40%) of credit card users.

[2] https://themoneycharity.org.uk/money-statistics/ See page 5 of the monthly PDF.

Generally, it is highly undesirable for people to use unsecured credit to cover a deficit budget. In this context, the FCA should take note of reports by the debt charities (e.g. Money Advice Trust and StepChange) that an increasing proportion of their clients are in a deficit budget.[3]

A deficit budget is one where, even after taking advice, a person still has a negative gap between income and expenditure. Their income is simply too low to cover the basic minimum living expenses of the UK in the 2020s.

Such people do not need debt. They need an income boost in either financial or in-kind terms, for example: a job or higher paid job, increased benefit income or housing support, increased child support or items from a food bank and other channels of charitable giving.

The existence of deficit budgets for large numbers of people in the UK is a policy issue that needs to be considered urgently by central and devolved government policy makers. MPs across the political spectrum have drawn attention to the issue. The situation will be made worse if Government goes ahead with its present intention of cutting the £20 boost to Universal Credit in 2021. The Resolution Foundation has estimated that this will lead to income cuts of 6-8% for those in the lowest income deciles.[4]

We urge the FCA to add its voice to the call for a response to deficit household budgets, in the context of how this intensifies the challenge of regulating the unsecured credit market.

We agree with the observation that there may be a gap in the **mid-priced (50-90% interest rate) part of the credit market**. For example, credit cards with higher than normal interest rates may offer people a way back to an improved credit rating. However, there are risks that such borrowing may tip over into new cycles of unaffordable debt. From our point of view, we wish to see rules that help people make financially capable decisions. The rules and good money advice need to be leaning in the same direction.

Salary advance credit creates a different type of risk, particularly relevant to the rising rate of redundancies from the economic impact of Covid-19: what happens if a person loses their job? Will they also lose their final pay and holiday pay to pay back the salary advance debt? This interacts with the benefit system, where currently there is a five week wait for Universal Credit based on the assumption that people will have a final paycheck to cover the wait. If people have no savings (a large minority of the population) and no income during this period, they will fall into destitution and potentially further debt while they wait.

[3] See StepChange monthly Covid impact reports.
[4] RF Analysis of the Spending Review, November 2020.

The rules applying to salary-advance-type credit need to be considered in conjunction with the rules on accessing social security and helping people maintain positive household finances.

Theme 2: Change and innovation in the supply of credit

We are aware of innovation in the supply of credit though being consumers ourselves, through what we hear people talking about and asking about in our workshops and through the approaches we receive from credit innovators. Over the last year we have had discussions with seven or eight innovators, who are developing several types of new business model. The discussions range from sharing information to potential joint work to charitable giving.

We have noted from these discussions:

- A variety of business models, some of which are quite hard to understand even after reading website material and hearing in-person explanations.
- The incorporation of financial management apps and concepts into some of the models.
- Some models seem to be inside the FCA unsecured credit perimeter while others, if their revenue comes from retailers for example, may be outside the perimeter.
- Many marketing names are used for the services provided, making it potentially hard for consumers to realise they are borrowing money. See, for example, the amusing summary by Hyperjar in its *Dictionary of Debt*.[5] The emphasis in naming and marketing is instant gratification: don't wait, get it now, pay later.
- Some models are sold to an employer as an employee benefit but may involve the employee accumulating or consolidating debt and getting into financial trouble in the medium term or if they lose their job.

We have also noticed a rapid escalation in point-of-sale (POS) credit, with consumers directed to one or several buy-now-pay-later options as part of the sale process. One of our colleagues reported that during a recent Internet purchase he was repeatedly steered to a POS credit provider even though he was trying to make a standard card payment.

This ease of access to credit coupled with the temptation to 'get it now' makes use of the human bias toward instant gratification and raises the risks of adverse outcomes as we highlighted in our comments on Theme 1. **We would like to see several regulatory responses to this:**

[5] https://www.ukstartupmagazine.com/hyperjar-launches-guide-to-stop-people-becoming-indebted-on-black-friday/

- Making sure that all widespread forms of consumer credit and borrowing against pay are within the FCA perimeter and have clear rules applying to them.
- Clarifying what the different models are offering. The business model should be clear to those researching it and the fact that they are taking on debt should be clear to consumers, along with (of course) their exact terms of repayment.
- Making sure that the messages communicated by credit providers are aligned with what the FCA, MaPS, Government, ourselves and many others know to be the basic rules of good personal financial management.

Theme 3: The role of regulation in unsecured credit markets

Building on our remarks under Themes 1 and 2, **the key things we would like to see are**:

- Common overall rules applying to all forms of unsecured credit and borrowing against pay.
- Ensuring that all widespread forms of unsecured credit are within the FCA perimeter. We would prefer that all consumer financial services without exception were within the perimeter, though we recognise the practical challenges in achieving this. This is one reason we have advocated the strengthening of the FCA framework by introducing an actionable Duty of Care.
- Amend the credit card minimum payment rule to introduce a higher initial payment followed by constant £ payments thereafter.
- Ensure that old types of risk do not re-emerge with credit innovation. For example, a few years ago there was a serious problem with continuous payment authorities, which some debt collectors were using to screen and clean out people's accounts, making their particular debt into the top priority debt for that consumer, regardless of other considerations. This was stopped but might re-emerge in the context of Open Banking.

We would also like to pose a question to all the regulators: to FCA, Bank of England and HMT, which is 'why are the interest rates for unsecured credit so high, given the virtually zero interest rate environment that has developed since the credit crunch and Covid-19?' As we highlight monthly in *The Money Statistics* (see page 15), the gap between the Bank of England base rate and credit card rates has widened from around 10% to over 20%. The gap for overdraft rates widened similarly, even before the latest jump to over 30%.

There may be demand-side reasons for this, but it seems highly anomalous that rates for unsecured credit have been going up while all other types of debt, including government debt, corporate debt, term loans and mortgages have been going down. If money is now free, how come it costs so much to take an unsecured loan?

We think that the consumer protection approach to unsecured credit needs to be supplemented by a market study on competition and price setting in these markets.

Looking forward, we are aware of the arrival of **new payment systems** based on Open Banking which could potentially revolutionise our whole payments and banking system. For many people, what has traditionally been known as 'banking' may become an adjunct to their payment app, rather than the other way round. **This may lead to many new forms of unsecured credit and we suggest the FCA takes a proactive forward look at what is coming down the road**, for example by looking at what has already happened in some overseas markets, e.g. China.

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

Covid-19 has been described as 'The Great Unequaliser.'[6] Multiple UK survey-based reports show a consistent picture of the unequal financial impact of Covid-19 and the related public health measures.[7] Roughly speaking, a small majority of households have seen no change to their incomes, around 10% have seen their incomes rise, while 30% of households (over twenty million people) have seen either moderate or severe falls in income. According to the Resolution Foundation, many households suffered a double hit during both the spring and summer. Many will probably experience a third hit over the winter as the next phase of the crisis unfolds.

The negative income shock has been spread across all income groups, even those above £100k per year (according to RF and StepChange) but the *distress* from the income shock is highly concentrated in lower income groups and especially affects women, single and couple parents, people from minority ethnic communities, young people and renters. Some people fall into all these categories simultaneously.

Higher levels of distress are being reported even though the Government intervened on a massive and welcome scale with its furlough income support scheme and other measures. But some groups, especially the self-employed and gig economy workers, have not been well covered by these measures and are experiencing severe economic distress.

The deferral measures mandated by the FCA were very welcome and millions of people have benefited from them. However, a debt postponed is not a debt repaid. We are extremely worried, as we highlighted in the media release accompanying our November

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[6] https://journals.sagepub.com/doi/full/10.1177/0141076820925434

[7] See the Covid impacts page in our monthly *Money Statistics*, which includes key points from reports by the FCA, Resolution Foundation, StepChange and Joseph Rowntree Foundation.

Money Statistics that a household insolvency crisis is building and may break once we come out of the health emergency of Covid-19 in 2021.

As an example of likely pressures, we note the report from Joseph Rowntree Foundation that 350,000 households have already been spoken to by their landlord about eviction or served with an eviction notice.[8]

The FCA, through its Covid-related instructions and vulnerability guidance, has put in place a regime for considering the individual circumstances of people in debt and exercising forbearance where this is needed. This is good, but because of the scale of the Covid effects, we are not sure that this will be enough by itself. **FCA, working with BoE and HMT may need to put together a new household solvency strategy, to enable people to keep afloat for the next two years, including keeping their houses and rented properties.**

Were a household insolvency crisis to develop, this would make economic recovery immensely harder. There is already the risk of the private sector and public sector trying to deleverage (reduce debt) at the same time, which could see the UK economy go into a worse period of stagnation than occurred after the credit crunch. In our view, for the health of household budgets and household survival, everything possible needs to be done to avert this.

Fortunately, with the international interest rate environment now being zero or negative, UK government debt servicing costs are falling[9] and there is more room for manoeuvre than there might have been in earlier decades.

One final point: we have been concerned about the **treatment of credit scores** during the Covid emergency. Consumer credit scores were supposed to be unaffected by the deferral measures, but the pattern of borrowing and repayment still remains on people's records and may become activated at a later date by the consumer's inability to make payments post-Covid at the speed they want to (for lack of financial capacity). There has also been a lack of consistency in how the different agencies have approached this issue.

We suggest the FCA keep looking at this issue from the point of view of trying to make sure that as we come out of the Covid recession, agencies take a consistent approach and certain borrowers are not penalised inappropriately going forward.

[8] JRF, *Struggling Renters Need a Lifeline this Christmas*, November 2020.
[9] Office for Budget Responsibility.

The Money Charity is the UK's financial capability charity providing education, information, advice and guidance to all.

We believe that everyone achieves financial wellbeing by managing money well. We empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier, more positive life as a result.

We do this by developing and delivering products and services which provide education, information and advice on money matters for those in the workplace, in our communities, and in education, as well as through influencing and supporting others to promote financial capability and financial wellbeing through consultancy, policy, research and media work.

We have a 'can-do' attitude, finding solutions to meet the needs of our clients, partners, funders and stakeholders.

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