The Woolard Review - A review of change and innovation in the unsecured credit market

Report to the FCA Board, published 2 February 2021

Contents

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How to navigate this document

- returns you to the contents list
- takes you to the previous page
- takes you to the next page
- prints document
- email and share document

Disclaimer

While this review was commissioned by the FCA Board, it has been conducted at arm's length from the FCA and its contents do not necessarily represent the position of the FCA. All opinions and conclusions expressed in this report are those of the Review, rather than the FCA.

Introduction

Credit is part of most people's lives in the UK. Used well it can be a helpful tool, but can also cause consumer harm when out of control. Unsecured credit can come in many forms, and the market has seen some recent rapid innovations. The market has also been changing, as a result of regulation and the impact of Covid-19.

This review has provided an opportunity to step back and consider these developments and how the FCA and other authorities can take a holistic approach to regulation of the sector. The recommendations, and any errors, are mine, but further action will be a matter for the FCA Board to decide. Achieving change and delivering outcomes will also depend on working in partnership with HM Treasury, a range of other government departments, other regulators, consumer groups and the third sector along with the active cooperation of the industry.

I was assisted by an advisory panel comprising: Phil Andrew (StepChange), Steven Cooper (Experian Limited), Natasha de Teran (FCA Consumer Panel, Scholar at Carnegie Endowment for International Peace), Kirsty Good (MoneySavingExpert.com), Malcolm Le May (Provident), Vim Maru (FCA Practitioner Panel, Lloyds Banking Group), Rebecca Pearson (Bupa Care Services), Marlene Shiels (FCA Smaller Business Practitioner Panel, Capital Credit Union), Caroline Siarkiewicz (The Money and Pensions Service), Helen Undy (The Money and Mental Health Policy Institute), Kirsty Ward (M&S Bank and Services) and Therese Chambers (FCA). I am very grateful for their advice and wisdom.

The Review Team was led by Wes Ball, ably supported by David Mendes da Costa and Kathryn Baildon-Smith. We were assisted by Siobhan Carberry. I am very grateful to the Review Team for their dedication and the credit for writing much of this report is due to them. I would also like to thank staff at the FCA who have provided technical advice and assistance during this review.

During the course of the review, we were able to benefit from talking to a wide range of people across the country and internationally. We held 3 virtual roundtables, attended by 68 people, had 64 written submissions to our Call for Input and conducted 22 individual interviews. We also undertook our own original qualitative and significant secondary research.

What emerges from the review is detailed in the following executive summary, but I would draw attention to an urgent need to regulate all buy now pay later (BNPL) products. While the emergence of unregulated BNPL products has provided a meaningful alternative to payday loans and other forms of credit, BNPL also represents a significant potential consumer harm. The FCA should work with the government to seek amendments to legislation as soon as possible to ensure such products are regulated by the FCA. Given the immediate passage of the Financial Services Bill, this is the one area where I have also written directly to Treasury ministers in parallel with placing the matter before the FCA Board. The letter is published on the Review website.

Decisions on taking forward this and the other 25 recommendations now rest with my former colleagues on the FCA Board. Taken as a whole, I believe this report sets out how we can have a better unsecured credit market in the UK, and I very much hope the FCA will put in place a programme, working with others, to deliver the recommended reforms.

Christopher Woolard CBE
Chair, Review of Change and Innovation in the Unsecured Credit Market

Executive summary and recommendations

The UK unsecured credit market has evolved in its modern form since the late 1950s to become an integral part of how most consumers live their financial lives. Most will at some point rely on a credit card, loan or overdraft. More recently, there has been a marked shift in innovation including the rise of payday lenders, unregulated buy now pay later (BNPL) products and advances to employees.

Regulation has reshaped the market since the FCA took on responsibility for it, and coronavirus (Covid-19) has posed significant challenges in terms of both protecting consumers and the viability of business models.

Access to credit is a major consideration in the market, including the relative lack of mid-cost options for sub-prime customers. Credit information (largely provided by credit reference agencies) is vital to the functioning of the market.

This report was commissioned by the FCA Board with the aim of concentrating on innovations in the unsecured credit market and asking whether more needed to be done to ensure a healthy, sustainable market.

The short answer is yes. To highlight a few key issues:

- To have a long-term, healthy market certain new credit products that are currently unregulated need to be brought within the regulatory framework as a matter of urgency.
- The economic effects of the pandemic will drive demand for debt advice. A well-functioning debt advice sector is essential to support a healthy credit market. Providers of free debt advice need access to secure, long-term sources of funding to ensure that advice is available to those in need. Debt solutions must be suitable - meaning known problems in the personal insolvency sector need addressing – and fees for Debt Relief Orders (DRO) should not prevent the poorest in society accessing the help they need.
- For the good of consumers and firms there needs to be a more outcomes focused approach to regulating the credit sector that looks at how products are used in the real world and consistently regulates on that basis. Regulation should focus not just on affordability, but on conduct across the lifetime of the product. Learning from the experience of Covid-19, there also needs to be a more consistent approach to forbearance across firms.
- Greater emphasis needs to be placed by the FCA, but also the government and other stakeholders on ensuring a holistic approach to key issues – ranging from long term debt advice strategies, boosting the availability of alternatives to high cost credit, and the treatment of the very poorest when they need help.
- There are significant opportunities to build a better credit information market to the benefit of consumers and lenders.

By its nature this is not a full post-implementation review of individual regulatory interventions made in the past few years, although this report will reference these. The report gives an introduction to the market, then considers challenges posed by the Covid-19 pandemic, access to credit, innovations and regulation.

The following recommendations are discussed in the main body of the report and are organised here by topic, the first three of which are particularly urgent:

Innovations in the market can bring significant benefits, but also pose potential consumer harms that need to be addressed as soon as possible. In particular, the unregulated BNPL market more than trebled in size in 2020, poses potential harms to consumers and needs to be brought within regulation to both protect consumers and ensure it is sustainable.

There has been significant growth in unregulated BNPL products in recent years. The products and business models in the market, as well as those which may be developed in the future, can lead to harm. Regulatory oversight is appropriate to ensure that the product develops in a way which is beneficial to the end consumer. As a matter of urgency, the FCA should work with the Treasury to ensure the necessary amendments to legislation are made to bring BNPL products within the scope of regulation. Once the necessary powers are obtained the FCA will need to develop a proportionate regulatory framework including addressing how credit information should work within this market. In defining the regulatory framework for BNPL, the FCA and the Treasury should take care not to include other non-financial organisations that rely on the current exemption, including healthcare services and sport clubs.

Employer Salary Advance Schemes (ESAS) offer a low-cost alternative to using credit like payday loans or overdrafts. If used appropriately they can give employees benefits and greater control of their finances. While wider regulation may not be immediately necessary, the FCA should take a proportionate approach and continue to closely monitor market developments and guard against risks to individuals. These risks can include inappropriate relationships between employers and lenders. For example, lenders 'locking in' employers through linked commercial contracts, or cross-selling of inappropriate financial services products to employees. The FCA working with the government should encourage ESAS providers and major employers to draw up a code of best practice. Where firms are regulated for part of their activity by the FCA, the FCA should look to formally recognise the code. Further, major employers should be encouraged to only contract with ESAS providers adhering to this code.

The growth of online lending is one of the main areas of change in the credit market. Many of the features of digital platforms which some consumers find beneficial - such as smooth consumer journeys, 24/7 access and not needing to interact directly with other people - can present problems for others. These problems are often enhanced when consumers are vulnerable. The FCA should ensure it has in place guidance for digital design in the consumer credit sector that focuses on good consumer outcomes, ensuring consumers are informed and remain in control of their decision-making. The FCA should consider updating its disclosure requirements to make them more suitable to a digital age.

The benefits of digital lending are not available to everyone. The FCA should continue to monitor digital innovations in the consumer credit market and ensure consumers who don't want to, or are unable to access digital platforms, aren't unduly excluded from accessing credit.

As a result of the pandemic the demand for debt advice is likely to more than double. Ensuring strong provision of debt advice and debt solutions will be critical to a sustainable market in the long term and the recovery from Covid-19.

Measures introduced by the government and the FCA have provided essential but temporary support to people affected by the pandemic. For some, the economic impact of the pandemic has been severe, will not be temporary, and there will be increased need and demand for suitable debt solutions to help them recover. Estimates vary, but around 1.5 million additional people may need some form of debt advice. To ensure that the imminent demand for debt solutions as a result of the pandemic is met, the FCA must without delay coordinate with the UK government, devolved administrations and insolvency regulators to ensure that suitable debt solutions are available to best serve people in financial difficulties. This should include identifying quick actions to remove or reduce barriers to accessing suitable solutions (including fees) and steps to reduce consumers being driven towards unsuitable solutions (including the role that marketing plays in this).

Across the UK there are multiple regulators covering different aspects of debt advice and debt solutions and it is essential that this does not lead to divergent outcomes for consumers who are in financial difficulties. The FCA, Insolvency Service and Accountant in Bankruptcy (Scotland), with support from government, must cooperate to swiftly remedy the issues that can be observed in the Individual Voluntary Arrangement (IVA) and Protected Trust Deed (PTD) market (neither IVAs or PTDs are regulated by the FCA). This should include close attention to problems created by the fee structure of IVA/PTD products on debt advice and lead generators. In the longer-term, the FCA should collaborate with these bodies to create a coherent and consistent vision of the debt solution market and a plan to bring this about.

People with significant debt problems and low or no disposable income have few options available to them. Debt advice for these people is more complex and costly as a result. To enable the debt advice sector to operate efficiently at a time when it will be under significant strain, barriers should be reduced to people accessing suitable debt solutions. In particular, it is unfair when the very poorest are asked to provide £90 for a DRO application. The FCA should discuss with the government how an emergency fund could be provided to cover the cost of the DRO application fee for people who cannot afford the fee but who would benefit from the solution. This could be delivered to the poorest clients through debt advice providers where they act as DRO administrators, as they have sufficient information to assess if an individual would have available funds to cover the fee or not. Alternatively, of course, government may wish to consider if the fee itself could be amended, waived or reduced, but like other fees is based on a cost-recovery basis.

Although action taken by the government and the FCA reduced the immediate impact of Covid-19 on consumers, Covid-19 will leave many open to financial shocks for some time to come, increasing the demand for debt advice. The FCA should work with Money and Pensions Service (MaPS), government and any other agencies to ensure that there is a long-term, multi-year strategy in place. The sector needs to be securely funded to meet the demands of the pandemic and this is an opportunity to place the not-for-profit sector on a more sustainable footing in the long-term, particularly through the use of multi-year funding settlements. The FCA should actively support the efforts of MaPS to place the free debt advice sector on a strong, sustainable and fair financial footing that reflects the causes of debt.

This year will also see the introduction of the Government's Breathing Space scheme and there are plans for the introduction of a Statutory Debt Repayment Plan (SDRP). The combination of Covid-19 and new statutory debt solutions such as SDRP have the potential to change the debt advice and debt solution landscape and there is a case for taking this opportunity to look at how the sector works as a whole and how it can best deliver for those most in need.

Having a sustained response to Covid-19 and related issues will be important to consumers and the future of the market including examining credit masking and more prescriptive forbearance.

In the early part of the Covid-19 crisis, the government and the FCA acted quickly to maximise the chances of people who needed short-term support being able to recover by not having a mark on their credit file. In context, and with Credit Reference Agencies (CRAs) unable to agree a viable alternative with lenders at speed, this was the right course of action. However, working with lenders and CRAs, the FCA should conduct a review of how forbearance is reflected in credit information and how this affects decisions made by lenders and consumers. This should:

- Assess the potential impact of the approach taken to the 'masking' of credit files.
- Look at the current arrangements for reporting forbearance to CRAs and whether these are consistent and adequate.
- Identify any areas where credit information could better reflect individual consumer circumstances and respond in a more nuanced way to changes in those circumstances. For example, having a 'neutral' marker that indicates an individual needs help because of Covid-19 on a longer-term basis, as suggested by some lenders. Any alternative approaches to the masking of credit files, including temporary markers, would need to be effective and responsive to a range of circumstances in the future. As part of this, the FCA should work with industry and consumer groups to set out clear outcomes for what reporting of arrears, default and forbearance should achieve for lenders and consumers in both the short-term and longer-term.

In 2020, the FCA acted decisively by fast-tracking the policy process for critical pieces of work to respond to the emerging risks created by the pandemic. This allowed the regulator to be proactive and shape an evolving economic environment. The crisis and its impact are continuing into 2021 and the FCA must continue to act in a similarly decisive and rapid way where it identifies emerging harms. This should include work set out in Chapter 5 (and summarised below) to create a more prescriptive and consistent approach to forbearance, so that consumers in financial difficulties can benefit from this as quickly as possible. The FCA should also consider whether action may be needed to deal with emerging harm related to access to credit, treatment of existing consumers and increased levels of vulnerability of borrowers as a result of the pandemic.

A sustainable market needs more alternatives to high cost credit

Looking at the credit market from a holistic perspective the biggest potential harms occur where there is a need for those on lower incomes or benefits to borrow.

In the preventative space, as well as affordability and repeat lending guidance, the FCA should provide government with evidence and analysis on the impacts of different social policies, including Universal Credit, on the demand for high-cost credit so that government can identify ways to reduce consumer harm in this area.

Despite positive efforts to encourage more alternatives to high-cost credit, the market has not delivered at scale, and further reform is needed. This includes liberalisation of the approach taken to regulating credit unions and to encourage more mainstream lenders to participate at lower costs in this part of the market.

Credit unions offer an important alternative to high-cost credit and enable wider financial inclusion. To fully realise their potential there is a case for removing some of the current restrictions on their activities. The FCA should work with the Bank of England, Treasury and Northern Irish government to set the timetable on updating the Credit Unions Act 1979 and Credit Unions (Northern Ireland) Order 1985 to allow credit unions to expand their product offering.

Consumers can not benefit from greater availability of alternatives to high-cost credit if they are not aware of them. Many consumers use forms of credit which they see others around them using and steps will be needed to effectively raise awareness of alternative products. The FCA should work with Fair 4 All Finance to identify and address barriers preventing consumers having a better awareness of alternative credit products. Where there are regulatory barriers the FCA should seek to remove them where appropriate.

There is change and innovation in illegal money lending, including through online platforms. It is essential that consumers are aware of the risks from illegal money lending in the same way as the FCA has acted around investment scams. The FCA should work with the English, Scottish and Welsh Illegal Money Lending Units, The Northern Irish Consumer Council, industry participants and debt advice charities to increase consumer awareness of the risks of engaging with illegal money lenders. As part of its wider work on fraud with online search firms the FCA should explore removal of illegal online lenders from search results.

As with credit unions, community lenders offer a valuable alternative to high-cost credit. They should be encouraged to grow or subject to legislative change, combine with credit unions. The FCA, the Treasury and Responsible Finance should report on ways to increase the lending capacity of Community Development Finance Institutions (CDFIs), for example, through subsidies or the development of investment incentives.

To date, mainstream lenders have been reluctant to offer or fund alternatives to high-cost credit. Greater involvement of these lenders directly in non-prime credit markets, with their expertise and economies of scale, is essential to driving competition and innovation. Consumer choice and outcomes will likely remain limited without this. The FCA in collaboration with the Treasury, Fair 4 All Finance and leaders from industry, should convene discussions with mainstream lenders on their participation in providing alternatives to high-cost credit. These discussions should seek to find ways to overcome the barriers (eg regulatory and reputational risks) to entering this market.

There is an opportunity to build a better credit information market, underpinning a sustainable credit market and better lending decisions.

Throughout the Review the importance of credit information has been stressed by many parties, especially in terms of underpinning the healthy operation of the market, reinforcing affordability and the systemic sustainability of the credit sector. The FCA should resume its Credit Information Market Study and in particular look at how improvements could be made in the speed and sharing of information across the credit sector. There is a genuine opportunity here not just to respond to the challenges elsewhere in this report, but to build a better system for the future.

The credit information market plays an essential role in supporting good outcomes in lending markets. Access to credit is often dependent on the availability of high-quality credit information and changes in the way that information is recorded can take a long time to implement. Through the Credit Information Market Study or as part of a wider strategy, the FCA should:

- make clear the outcomes which the market needs to achieve for consumers and lenders, and how these will support a healthy credit market, including where consumers interact directly with CRAs and Credit Information Services (CISs)
- assess whether the credit information market is operating is a way which enables consumers who use credit responsibly to build their credit file and access more credit options
- consider whether a mandatory reporting requirement would drive better outcomes for consumers
- consider the case for introducing rules to require creditors to report to courts when a County Court Judgement (CCJ) has been satisfied or partially satisfied, to drive up the quality of existing credit information
- identify and address barriers to widespread use of Open Banking data, with particular attention to alternative credit providers

The standards around how credit information is submitted and shared have developed over time and with little regulatory oversight or direction. Legacy infrastructure is regularly cited as a limiting factor in making changes to how information is reported. The FCA, working with the Steering Committee on Reciprocity (SCOR), lenders and consumer groups, needs to:

- consider whether the current governance arrangements deliver good outcomes and to implement new arrangements if not
- identify areas where legacy infrastructure is creating barriers to change and innovation in the credit information market and set out a timeline for improving or updating systems

In addition, consumers who have experienced financial difficulties and have poor credit files struggle to access a wide range of credit options. These consumers need products which not only offer a suitable and sustainable source of credit, but which are designed to help them to improve their credit files and build financial resilience. The FCA should:

- Conduct work to identify whether 'credit builder' products currently in the market are effective in supporting consumers to access a wider and cheaper range of credit products. If these products aren't found to be effective, the FCA should take steps to limit the use of terms like 'credit building'.
- Include a theme on a future cycle of the Regulatory Sandbox to accelerate the growth of products which support consumers to transition from high to low-cost credit and increase their financial resilience.

A sustainable market needs to be underpinned by regulation focused on outcomes and how consumers really use credit. The FCA should review repeat lending.

Since taking over responsibility for the regulation of consumer credit, the FCA has had the opportunity to study specific parts of the market and product types and respond to the harms which it has identified. This has been necessarily undertaken by sub-sector but as the FCA takes forward its Business Plan Consumer Credit Priority there is an opportunity for the regulator to set out clear outcomes which a healthy credit market should be achieving across all products and sectors. The FCA should use its Business Plan Priority to take an outcome based approach to regulating the credit market and set out clearly what the market should be achieving at each stage of the consumer journey and lifecycle of a product and how regulation can support that. This should include outcomes regarding: financial promotions, information disclosures, affordability assessments, persistent debt/repeat lending, forbearance, debt advice and solutions and debt collection. Outcomes should also be developed around the recovery of consumers who have had financial difficulties and their ability to access credit over time. Regulatory initiatives should be identified and evaluated with reference to these outcomes. This should include ensuring equivalent approaches and protections where consumers use particular products as substitutes or where similar harms are present. The FCA should make these outcomes public to ensure firms have clarity around the direction of future regulatory initiatives.

For example, a more holistic approach needs to be taken to regulation that looks at the substitutability of credit products and treats them based on the outcome. For example, although home collected credit may be structured as a series of single loans, if it is being used on a repeat basis by the consumer as a revolving line of credit, it should carry the same regulatory responsibilities and protections. The FCA largely has the ability to secure this, but should also work with the Treasury if changes to legislation are needed. The FCA should also ensure as much emphasis is placed on conduct during the lifetime of a loan as at the point of initial affordability assessment.

The FCA and Financial Ombudsman Service (FOS) already coordinate in order to ensure their activities align and drive shared outcomes. However, this is not always the perception of lenders and their funders which can have a potential cooling effect on investment and growth. The FCA and the FOS should take forward a coordinated campaign of external activity to reduce perceptions of regulatory uncertainty in the credit market, particularly for affordability.

Building on findings from the Credit Card Market Study and High-Cost Credit Review, the FCA introduced rules for repeat or persistent use of credit cards and overdrafts. Repeat use of fixed-term loans and 'low and grow' business models has led to fixed loans being used in a similar way to revolving credit and with similar risks. There is a place for such lending in the market, but consumers need the same level of protection as for revolving credit. The FCA should conduct a review of relending. This should set out clear outcomes covering repeat lending and persistent debt across all products. It should look at whether additional protections or guidance are needed around the relending of fixed-term loans to achieve these outcomes in light of the findings of the FCA's recent work on relending in high-cost credit.

In 2020, the FCA acted decisively during the early stages of the pandemic by introducing greater prescription into how firms treat customers in financial difficulties or who requested forbearance, even if they were not in arrears. As noted above, building on the temporary guidance in 2020, the FCA should conduct policy work to review its overall approach to forbearance. This should look to set out clear outcomes for the forbearance process and firms' responsibilities in achieving these. The FCA should consider a more structured and prescriptive approach to achieve a level of consistency between firms' approach to forbearance. This is likely to benefit both consumers and firms.

To achieve a regulatory system which is more outcomes focused across the whole consumer journey, changes will be needed to both the Consumer Credit Act 1974 (CCA) and the FCA Handbook. Much of the groundwork for CCA reform has already been laid by the FCA's 2019 report. The FCA must engage with the Treasury to prioritise the work on CCA reform.

The UK's exit from the European Union also creates additional flexibility in credit regulation which needs to be considered as part of the CCA reform work. This includes greater flexibility on information disclosures such as Annual Percentage Rate (APR) and the inclusion of examples of the cost of credit in pounds and pence. The FCA should conduct a review to identify what additional flexibility will be available to the FCA and the Treasury following the UK's exit from the European Union and how this can deliver regulatory outcomes in the unsecured credit market, including around information disclosures in simple terms like pounds and pence costs.

Next steps

Finally, while certain work is clearly very urgent, particularly BNPL the response to Covid-19 and debt advice, delivery of the overall package recommended by this Review will take time, especially with resources under pressure linked to the ongoing Covid-19 situation. A programme of reform needs to be set in place. Therefore, the FCA should appoint an accountable executive to carry forward the recommendations accepted by the Board. There should be a public timetable for change and the Board should report a year from now, and annually thereafter if necessary, on progress.

1 The market for unsecured credit

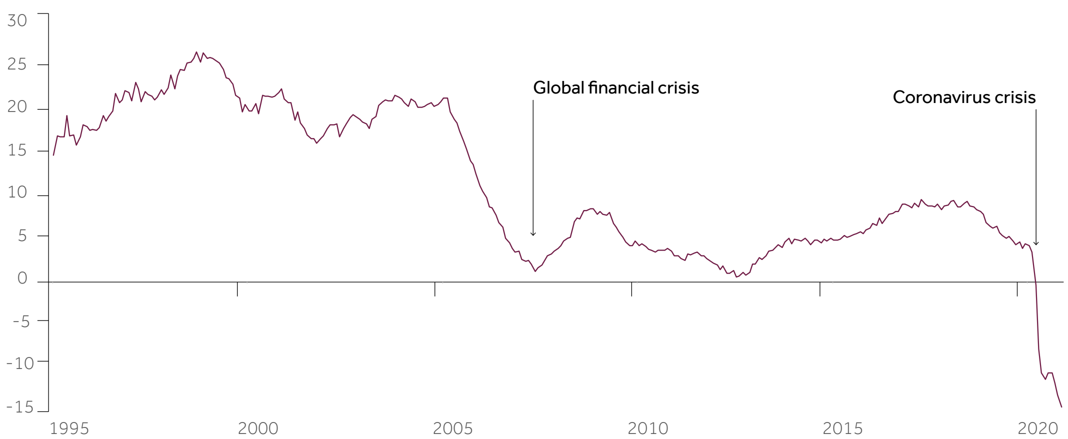
1.1 Credit is what credit does. The supply of money, goods or services on the basis of the trust that payment deferred will, in time and on agreed terms, be received, has been the heart of economies for centuries. From the tab in the bar, to the slate in the grocer's shop, small amounts of credit provided on the basis of established relationships have allowed people to get by and get the things they need. Credit makes economies work and has a social purpose.

1.2 Arrangements underpinned by law have existed in most societies globally since ancient times. But the growth of what we now recognise as consumer credit took off in the post-war period.

1.3 At first there were credit cards issued to individuals that would allow for goods to be invoiced to a firm – an early company credit card. By the late 1950s, the first cards for consumers had begun to be issued in the USA. Diner's Card, Bank of America's 'Americard' and American Express all provided people with a revolving line of credit across a (admittedly limited) range of retailers and service providers.

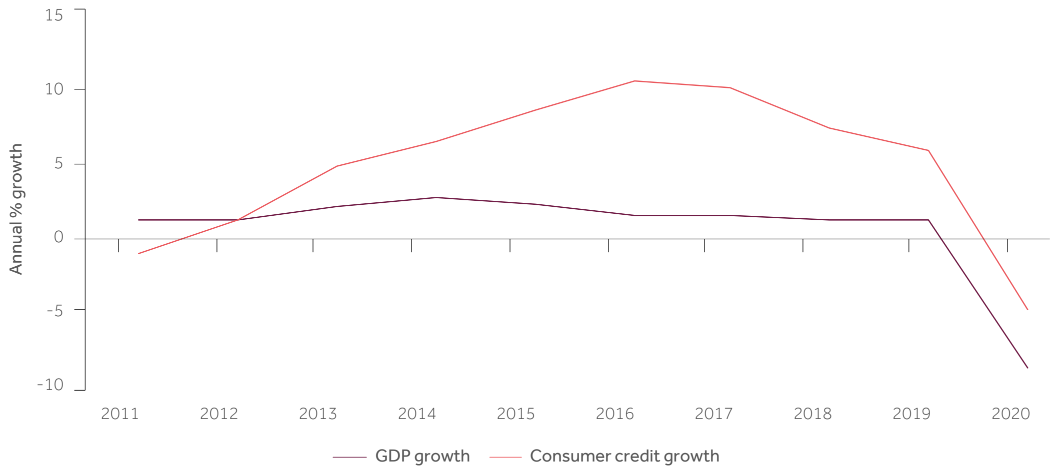
1.4 In the UK, the easing of economic restrictions on Hire Purchase in 1958 drove an increase in consumer spending on white goods and cars. In 1966 Visa introduced the Barclaycard to the UK. Their use became commonplace across the UK over the subsequent decades and by 2015 the FCA's Credit Card Market Study found there were over 30 million cardholders in the UK. As shown in Figure 1, there has been growth in credit card borrowing for the last 25 years, with a contraction in 2020 as a result of the Covid-19 pandemic. The effect of Covid-19 on consumer credit is discussed in Chapter 2.

Figure 1 – there has been growth year on year in credit card borrowing with two substantial dips around the global financial crisis and the current pandemic. Source: Bank of England



1.5 Looking across all consumer credit, the years following the Global Financial Crisis saw a reduction in borrowing. As Figure 2 shows, this had reversed by 2013 and since then growth in consumer credit borrowing has significantly exceeded growth in gross domestic product (GDP). In 2020, Bank of England statistics show that UK households collectively have over £240bn of outstanding consumer credit debt in the UK.

Figure 2 – the levels of consumer credit debt have grown significantly faster than GDP for most of the last decade. Sources: Bank of England, ONS



Consumers use a diverse set of products for a wide range of reasons

1.6 Today unsecured consumer credit comes in many forms, from lines of revolving credit like overdrafts and credit cards, to straightforward interest-bearing loans, to more personalised products like home-collected credit. Innovation continues to generate new products and the rise of digital lending has added to this growth. In recent years this has included unregulated Buy Now Pay Later (BNPL) products, which are interest free short term loans to spread payment of retail goods, and Employer Salary Advance Schemes (ESAS) which, whilst not legally a form of credit, facilitate employees getting access to earned income ahead of payday. These recent innovations are discussed in more detail in Chapter 4.

1.7 Throughout this review, 'BNPL' will be used to refer to unregulated BNPL credit agreements which rely on the exemption found in Article 60F(2) of the Regulated Activities Order (RAO). Where we refer to BNPL which falls within the FCA's remit, this will be specifically called-out.

1.8 Consumer credit is now part of many people's daily lives. For many it provides the ability to make large purchases by spreading the payments over time. Often it enables more short-term smoothing of income. For some it is used to cover essential bills like rent and utilities.

1.9 The FCA's Financial Lives survey which was completed in February 2020 found that 81% of UK adults (42.5 million people) had used regulated consumer credit within the last 12 months. In many cases these people were using forms of credit, such as credit cards, store cards and catalogue credit which do not charge interest if paid off in full each month. 30% of adults only use credit in this way and make repayments in full every month or most months.

1.10 There are some gender differences in the types of credit used. For example, women are more likely to use retail finance (such as catalogue credit and store cards), while men are more likely to use motor finance or personal loans. Men are more likely to hold a credit card than women, and are more likely to pay off their balance in full at the end of each month.

1.11 Consumer use of credit varies between different age groups. For example, 18-24 year olds are far less likely to borrow on a credit card, personal loan or motor finance compared with older adults, but are more likely to have borrowed from friends and family with around a fifth of this age group having done so in the last year.

1.12 The trend of younger people moving away from products such as credit cards and towards new offerings, including unregulated BNPL products was regularly raised by respondents to the review. Women are also more likely to be making use of these products than men, in part due to their strong uptake in the online fashion sector. Chapter 4 discusses these new products in more detail.

1.13 Many consumers hold more than one credit product or move between them. Although a consumer may clear their debt on one credit product, it is not uncommon for them to remain in debt as they transfer balances, take out new credit products or draw down on existing credit lines (such as credit cards). In November 2016, 89% of outstanding debt was held by people who also owed debt 2 years earlier. While approximately half of new borrowing is due to 'new' borrowers, these people are typically only able to access relatively small amounts of credit and account for a small proportion of overall debt.

1.14 This highlights a need for regulators to not become too relaxed when they observe improvements in specific products at particular lenders and to be aware of how consumers substitute between different products. In light of this, it is important that consumers get consistent outcomes regardless of what product they are using, especially where similar harms are present. This is discussed further in Chapter 5.

Not everyone can access mainstream credit

1.15 According to work done by the FCA in 2018, most growth in consumer credit was then in the prime sector – the borrowers least likely to suffer financial distress. Only a small proportion of all consumer credit debt is held by subprime consumers, however there are some important differences when we compare people holding different credit products.

1.16 The FCA's High-Cost Credit Review found that high-cost credit products are used by over 3 million consumers in the UK, some of who are among the most vulnerable in society – with low credit scores and with typical income levels, including benefits, between £15,500 and £18,000. These consumers often have unpredictable variations in their income and expenses. They are generally higher risk and borrow smaller sums than consumers of mainstream credit.

1.17 These consumers are not able to access mainstream credit, but this does not change their need for credit. Not being able to borrow to purchase essential household goods can mean people have to use more expensive options. For example, using a laundrette instead of having a washing machine is costlier in the long term. Often credit can be about balancing one-off purchases, like school uniform, and normal household bills.

The harms which can arise in sub-prime credit markets must be balanced against the harm of not accessing credit at all. Respondents to the review were generally in favour of having wide access to credit where it is affordable and sustainable.

1.18 In practice, this means having available forms of credit outside of the mainstream, including sub-prime and near-prime credit markets. Inevitably, the more risk associated with a customer the higher the risk premium attached to the cost of credit. Even when socially-motivated lenders are engaged, such as Community Development Finance Institutions (CDFIs), rates of interest can be in the high double digits. In 2018 work by FCA researchers noted that high-cost credit markets used by subprime borrowers were not rapidly expanding. On the contrary, in 2018, some were contracting. Chapter 3 discusses access to credit and ways to encourage growth of alternatives to high-cost credit.

1.19 Credit is not the right option for all consumers. There is a group of consumers whose personal circumstances will mean that any lending is likely to be inappropriate or unaffordable. As shown in the FCA's work on payday lending, some consumers' personal economic welfare increases over time when denied credit. Parts of the social welfare system are designed to help the poorest in society. There are clear links in most Western societies between the structure and operation of the welfare state, as well as employment, regulation and the level and type of demand for credit.

1.20 Respondents to the review highlighted that in addition to the absolute level of any welfare provision (which is clearly a matter for government and outside the scope of this Review), certain social policy developments may be a driving factor for the use of high-cost credit not all of which is affordable. Examples of points raised by respondents included:

- The wait for the first payment of Universal Credit (UC), including the five-week wait and any other delays in benefits being awarded, may lead some people to turn to credit to cover essential bills and rent in the interim.
- The abolition of the former Department of Work and Pensions-administered Community Care Grants and Crisis Loans for living expenses and its replacement with local schemes may have reduced the supply of an alternative to high-cost credit, although there is an emergency loan element available in UC. These issues were picked up by the Work and Pensions Select Committee's report Universal Credit: The Wait for a First Payment

Unaffordable borrowing and repayments

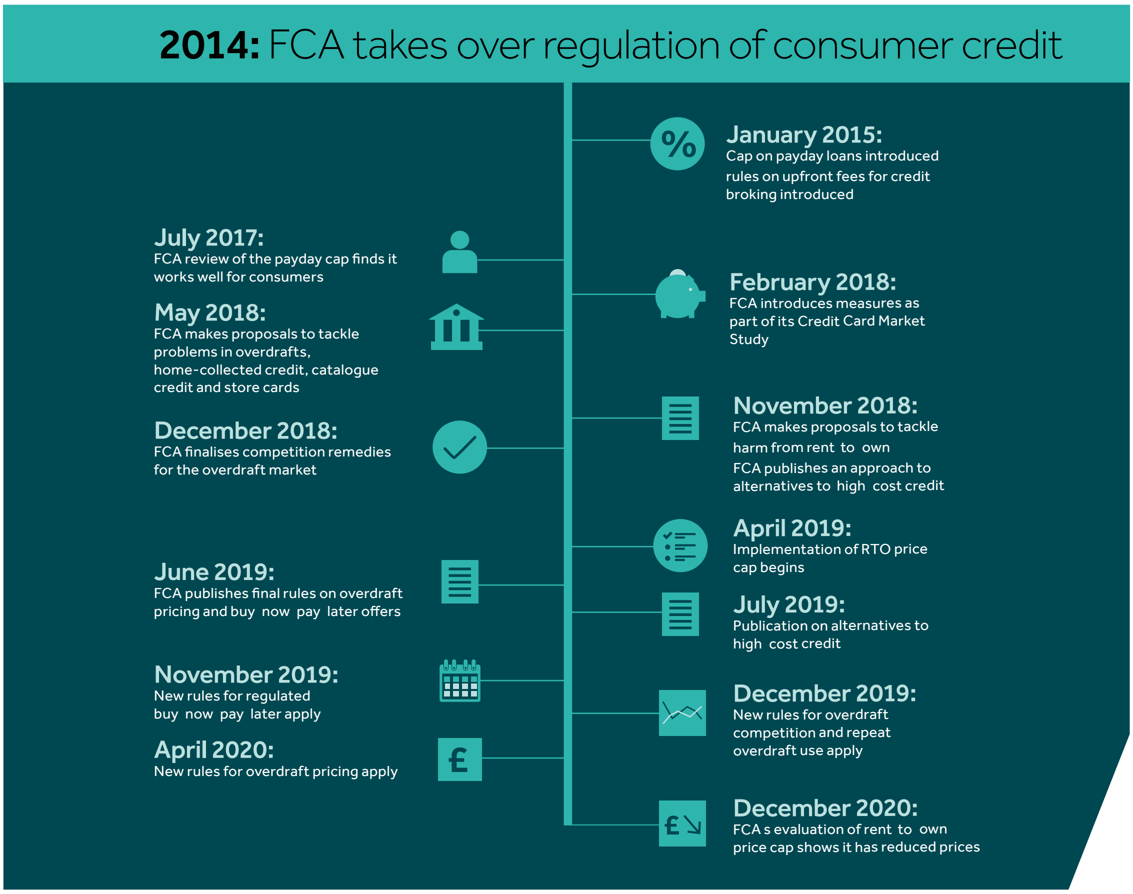
1.21 While credit can be useful – even vital – to many people, there are clearly ways that it can be harmful for consumers. Regulation has a clear role to play in identifying and addressing these harms. Box 1 shows some of the FCA's major interventions since it took over regulation of consumer credit in 2014.

1.22 A key driver of harm is where credit is not affordable. Where consumers continue to make payments on such debts they may be doing so only by cutting back on essential purchases, such as food and utilities; failing to repay other debts; or by taking out further credit. This situation is both harmful and unsustainable for the consumer. While borrowers may have experienced some benefit from receiving credit in the short term, in the longer term unaffordable credit places them in a worse position.

1.23 A key consumer protection is for lenders to carry out an assessment of whether a loan is affordable before the loan is offered. Where the assessment shows that a loan will not be affordable, the loan should not be offered. The effectiveness of these assessments depends on the availability of good quality credit information and lenders' ability to analyse that information. This can be supported by a well-functioning credit information market, as discussed in Chapter 3, which is also part of the FCA's regulatory remit, but ultimately it is a core competency of the lender to carry out these assessments effectively.

1.24 Affordability assessments are an important way to reduce predictable harm, however many money and debt problems can be created by unforeseen changes in circumstances. Health problems, relationship breakdown, bereavement and job loss can all have a detrimental impact on someone's financial position and make it harder for them to meet their obligations to creditors. The extent that this is harmful will depend in part on the actions of the creditor and their approach to forbearance. As a result, the FCA's requirements around forbearance are a critical way to reduce harm which cannot be addressed through affordability assessments. They also act as an additional protection where those assessments may not have been completely effective. This is discussed further in Chapter 5.

Box 1 – Major FCA actions since taking over regulation of consumer credit



Sustainable debt and repeat borrowing

1.25 Affordability assessments and effective forbearance offer ways to reduce harm where consumers have difficulties in meeting their repayments. In addition to this, the FCA has identified harm occurring for consumers who can afford to make repayments but who may end up trapped in expensive and persistent debt.

1.26 Following a market study of the credit card sector, the FCA introduced measures to address persistent credit card debt and to require credit card firms to use the data available to them to identify customers at risk of financial difficulties and take appropriate steps. These changes rebalanced incentives so that both firms and customers are encouraged to avoid credit card debt becoming persistent, and customers who cannot afford to repay more quickly are given help to do so. Following the High-cost credit review, these protections were extended to apply to store cards and other forms of retail revolving credit.

1.27 Similar issues around repeat use have also been identified in the use of overdrafts. The FCA has introduced rules requiring overdraft providers to monitor patterns of repeat use which may be harmful and to identify and help consumers using their overdrafts in this way.

1.28 More recently, the FCA published the results of supervisory work looking into relending in the high-cost loans market. For some consumers, these chains of loans will be unsustainable in a similar way to repeat use of overdrafts or persistent debt from credit cards. Regulation has a role to play in helping consumers retain control of their finances and to find a way out of persistent, expensive and unsustainable debt. This is discussed further in Chapter 5.

The cost of borrowing

1.29 Since taking over the regulation of consumer credit in 2014, the FCA has taken some decisive actions around the price of credit where there has been evidence of harm. Notably, price caps have been introduced for high-cost short-term credit and rent-to-own products. Regulation of credit often raises questions around balancing consumer protection against limiting access to credit. This is particularly true of pricing interventions. Careful and complex analysis is vital to understand the impact of any intervention on consumers who may lose access as a result. This will vary between different products.

1.30 In this context, looking to set a price cap across the whole of consumer credit, which some European nations do, would present significant challenges to assessing the impact on access. To apply across all credit without having a major impact on access, it would need to be set so high as to have little impact on most products. Alternatively, it could be set in a way that did create a low cap (for example, as done in the Netherlands) but the potential effects of this on access and business models would need significant consideration. For example, credit card penetration is about four times lower in the Netherlands than the UK. The FCA could provide further analysis of what might be the level at which consumer harm and benefit are optimised, but anything that had a significant effect on the expectations and lifestyle choices of a large part of the population would properly be a matter for Parliament. There are other issues that interact with wide spread credit caps – for example how far and how generous social welfare provision is in order to offset some of the lack of access to credit, which is again a matter for Parliament.

1.31 Preventing gaming of caps is challenging, as is taking account of repeat use of products versus fixed ones. For some individual products, the structure and level of pricing is a key driver of harm. In these situations, there may be a case for intervening around price and extending the scope of existing caps if needed. Looking across the high-cost credit market as a whole, there may be more benefit in focusing on actions to generate a more dynamic market around alternatives to high-cost credit and ensuring those consumers who are improving their creditworthiness can evidence this and be rewarded with more options and lower prices. This is discussed in more detail in Chapter 3.

1.32 There are also challenges around consumer awareness of the cost of borrowing. The cost of borrowing for the consumer is usually set by an interest rate or, less often, through fixed fees and charges, or a combination of both. For most forms of credit, the cost of borrowing is represented by the Annual Percentage Rate (APR) using a formula set out in regulation. The APR is intended to provide a comparison in the cost of credit as it includes the full costs of borrowing, including the interest rate and any associated fees and charges paid by the consumer.

1.33 The APR is often criticised as a way of representing the actual cost of credit as it is difficult to get a clear view on what the actual cost of credit would be in pounds and pence. There are also problems with using APR to compare the cost of very different credit products. However, it still has value as a way of comparing similar products. FCA research shows consumers understand the signalling effects of a high APR, although most would find it very hard to calculate the exact cost from it.

1.34 The recent FCA reforms in the overdraft market offer a useful example. In 2019, the FCA acted on the findings of the High-Cost Credit Review around the lack of transparency and complexity of overdraft pricing by introducing a requirement for overdrafts to be priced using an interest rate and with no fees or charges. This brings sufficient consistency to allow the APR to be an effective way to compare the costs of different overdraft providers. To help consumers better understand the actual cost of using an overdraft, the FCA required lenders to provide examples of costs represented in pounds and pence alongside a calculator where borrowers can work out their individual costs. More than one approach may be necessary when looking to help consumers understand the costs of borrowing and using APRs alone is unlikely to be sufficient.

1.35 More recently, we have seen innovations where the costs of credit to consumers are subsidised by a third party such as a retailer (for example in the case of unregulated BNPL). These subsidies help reduce the cost of credit but introduce conflicts of interest, as lenders may not see the end borrower as their main customer. This is discussed in more detail in Chapter 4.

2 The impact of Covid-19

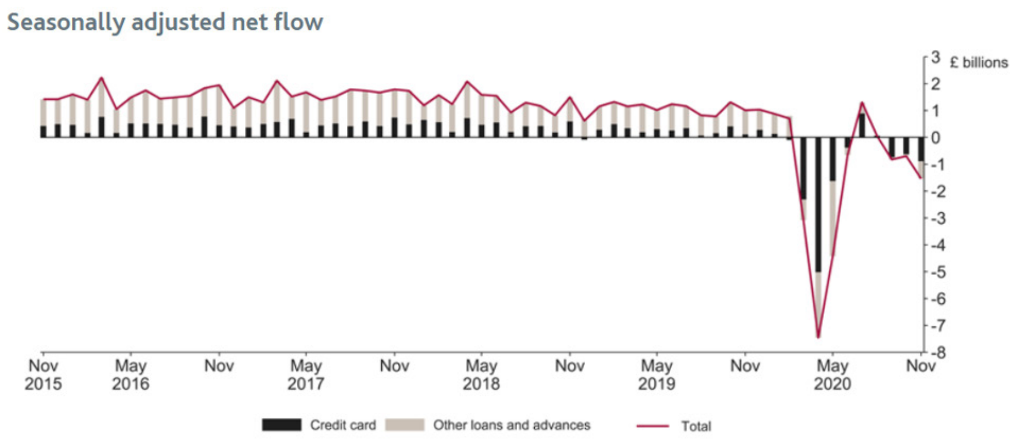
2.1 Covid-19 and the measures taken to tackle the pandemic have had a huge effect on every part of our lives. This remains the case now. At the time of publishing this report, the UK was in its third national lockdown. These measures have had a significant impact on the economy and, for many, led to reduced incomes or created uncertainty around future earnings. The potential effect on consumer credit markets at the start of the pandemic were stark, both in terms of consumers being able to meet existing commitments alongside essential spending, and for lenders needing to provide assistance and forbearance at scale. As a result, swift action was taken by the FCA and government to provide exceptional and immediate support to consumers facing temporary payment difficulties due to Covid-19.

2.2 This chapter looks at the effects the pandemic has had on consumer credit markets. It identifies areas where lessons can be learned, in particular on the importance of a sustainable free debt advice sector.

The effects of Covid-19 on consumers and their use of credit have varied considerably

2.3 For around a third of households the combination of working from home, less travel and reduced spending opportunities during the early stages of the pandemic increased their disposable income and meant they borrowed less and even repaid debt. Between March and May 2020, UK consumers repaid an unprecedented £15.8bn in consumer credit, as shown in Figure 3. This effect reversed briefly over summer.

Figure 3 – some consumers could repay significant amounts of consumer credit debt during 2020. Source: Bank of England



2.4 Different groups of consumers have not been affected equally. Research from the Institute for Social and Economic Research indicates that those earning less before the crisis have suffered greater losses in their earnings. People receiving the top 20% of earnings saw on average (median) a 2% drop in incomes, while those in the bottom 20% saw a reduction of 13%.

2.5 The effect of the crisis on people's finances has consequences for their use of credit. A survey conducted by financial charity Turn2Us suggests the number of people running out of money before the end of the week or month increased by 60% between March and September 2020. The FCA's Covid-19 panel research undertaken in October 2020 found 25% of adults feel it is likely, when considering their finances in the near future, that they will struggle to make ends meet over the next 6 months. These customers face a choice between borrowing or going without. The Resolution Foundation found that in the early stages of the crisis, lower-income households were twice as likely as high-income households to have increased their use of consumer credit during lockdown.

2.6 When looking at measures capturing vulnerability or financial resilience, overall Covid-19 has had a negative effect. The Financial Lives 2020 survey showed that in February 2020, 10.7 million adults in the UK (20%) had low financial resilience. The FCA's Covid-19 panel survey showed by October 2020, an additional 5.1 million adults found themselves struggling where they were not before. Positively, 1.7 million who had low levels of resilience were no longer in this situation. This means that between March and October 2020, the number of adults with low financial resilience increased overall by 3.5 million to 14.2 million, or 27% of UK adults. FCA research suggests the number of adults with characteristics of vulnerability has increased across the UK since February 2020. London has the highest levels of vulnerability in October 2020 and the biggest percentage increase since February 2020 (up by about a third from 44%). The second largest percentage increase has been in the South East (up by about a quarter from 42%).

Overall, the immediate effect of Covid-19 in the UK was to reduce supply and demand for credit across most products

2.7 While the picture of supply and demand varies between different credit products, data provided by credit reference agencies (CRAs) show that in March and April 2020 the number of enquires and applications for credit dropped significantly, but has since picked up. Demand for credit, shown in Figure 4, started to recover from mid-April 2020 and returned to pre-Covid levels by early June 2020. Supply of credit also increased after the March 2020 drop but is still below pre-Covid levels.

Figure 4 - Demand for consumer credit during 2020 reduced sharply during the first UK lockdown before recovering from May 2020, measured through levels of hard and soft credit searches. Source: FCA Credit History Information Panel.

2.8 Across mainstream credit products such as credit cards and personal loans, data provided to the Review by CRAs indicated that during the April 2020 lockdown, several lenders responded by removing products from the market. Those that remained generally did so with tighter lending conditions. Since May 2020, most card and personal loan lenders have returned to the market, although they appear to have been more risk adverse in their lending.

2.9 This correction in demand (and supply) may not be entirely bad news for consumers or the long term sustainability of much of the market given the growth in credit relative to gross domestic product (GDP) seen in Figure 2.

2.10 Supply of high-cost products severely contracted following lockdown. Many respondents to the Review suggested that this was unlikely to recover soon. Data provided to the Review suggests that there has been recovery in some parts of the sector, including home-collected credit but lending in other parts of the sector, including high-cost short-term credit (HCSTC) remains significantly lower than pre-crisis. Respondents suggested that reduced supply has been driven by increased uncertainty about the creditworthiness of borrowers and a reluctance to lend due to concerns that poor decisions made during the pandemic could come under future regulatory scrutiny. It is also possible that some of the reduction in supply has been driven by existing issues with some lenders' viability which, combined with the effects of Covid-19, has led to them exiting the market.

2.11 Reduced lender confidence, which is also seen in the Bank of England's Credit Conditions Survey, reflects the increased uncertainty around the future financial position of borrowers. This situation is likely to continue until there is more clarity around which sectors of the economy will recover and which will have longer-term scarring. The sectors where people are employed is likely to play a significant role in their ability to access credit in the near-future.

Actions taken by the FCA and government have protected consumers from the short-term impact of Covid-19, but problems are likely to occur in the future

2.12 The FCA responded to the pandemic rapidly and decisively by creating a temporary set of guidance for mortgage and consumer credit firms. The guidance set an expectation that firms would allow customers affected by Covid-19 to defer payments for a 3-month period (1 month for HCSTC products). As the crisis continued this was extended for a further 3 months and a further set of guidance on payment deferrals was published in November 2020 following the second lockdown.

2.13 Usually, missing 3 payments would have a significant impact on a customer's credit score which could reduce their ability to access credit or the price of any credit they are offered in the future. To avoid this, and increase uptake, the FCA's guidance required payment deferrals to be 'masked' on credit files so that there would not be an adverse effect on credit scores. The FCA also created guidance around overdrafts, including an expectation for the provision of interest free overdrafts up to £500. In September 2020, the FCA published Tailored Support Guidance. The guidance sets out how firms should treat consumers coming off payment deferrals and sets clear expectations around forbearance. This includes the need for firms to take consumers' individual circumstances into account when determining how best to help them.

2.14 The FCA's Covid-19 panel survey found 19% of adults who had any credit or loan product (excluding overdrafts) took out a payment deferral on a consumer credit product between March and October 2020. Of these people, 70% felt they would have struggled more without it. For interest free overdrafts, among all adults with an overdraft, 35% (3.9 million) said that the arrangement helped them financially.

2.15 Respondents to the Review were positive about the speed of the FCA's temporary guidance for credit providers and the strong focus on consumer protection. There was support for the clear role of payment deferrals. This raises the question of whether more prescription is needed to support consumers who are in, or may face, financial difficulties. We take this up in Chapter 5 but note here that the level of prescription was also driven by the need to ensure that firms could deal with a high volume of consumers in exceptional circumstances. Not everyone who took out a payment deferral needed one and for many consumers a more tailored approach to forbearance may have been in their interests had firms had the capacity to do so. The FCA and lenders adjusted to this more tailored approach after the immediate shock of the first wave of the pandemic. There may be merit in making the forbearance rules more prescriptive than they currently are. But this should not obscure the need for firms to take the individual needs of consumers into account when considering what help to offer them. The importance of tailoring forbearance to individual consumer circumstances was highlighted by the FCA in its Tailored Support Guidance.

2.16 Respondents frequently raised the 'masking' of credit files. Many viewed protecting consumers' credit files from a situation out of their control as generally positive, although the reduction in transparency and accuracy of credit information was seen by some to have created problems. Respondents noted that it has made some firms less willing to lend as they don't have the full picture of the consumer. In the short term, this may have a negative impact on access to credit.

2.17 It was appreciated that while the approach taken to deliver 'masking' was a fairly blunt solution, more refined approaches were not available at the time and it was important for the FCA to act swiftly. Lenders and Credit Reference Agencies (CRAs) were unable to quickly provide a consistent approach to reporting short-term forbearance that has no long-term negative impact on credit files. This raises wider questions about the ability of the credit information market to operate at pace and deliver change in the interests of firms and consumers. This is discussed further in Chapter 3.

2.18 These issues raise broader questions about how arrears and forbearance are reflected in credit information and the role that this plays in decisions made by lenders and consumers. During the first phase of the pandemic, lenders lacked a way to offer short-term forbearance and report this to CRAs in such a way that the credit file impact was also short-term, unless problems persisted. That would allow other lenders to be aware of the temporary difficulty but not have a longer-term impact where the difficulty is resolved. Currently, there is not a consistent solution which delivers this and short-term financial difficulties can have a much longer-term impact on credit files. This may act as a barrier to consumers seeking forbearance, even where it is in their best interests.

2.19 A more nuanced and consistent way of recording short-term and long-term forbearance on credit files may help firms to make better lending decisions and deliver fairer outcomes for consumers. There is an opportunity to be ambitious in the lessons learned from Covid-19 and seek a more tailored, 'neutral' approach to recording temporary difficulties that may better reflect the borrower's true financial position. This would help firms to make better decisions and enable borrowers to recover more quickly.

Recommendation 1

In the early part of the Covid-19 crisis, the government and the FCA acted quickly to maximise the chances of people who needed short-term support being able to recover by not having a mark on their credit file. In context, and with CRAs unable to agree a viable alternative with lenders at speed, this was the right course of action. However, working with lenders and CRAs, the FCA should conduct a review of how forbearance is reflected in credit information and how this affects decisions made by lenders and consumers. This should:

- Assess the potential impact of the approach taken to the 'masking' of credit files
- look at the current arrangements for reporting forbearance to CRAs and whether these are consistent and adequate.
- Identify any areas where credit information could better reflect individual consumer circumstances and respond to in a more nuanced way to changes in those circumstances. For example, having a 'neutral' marker that indicates an individual needs help because of Covid-19 on a longer-term basis, as suggested by some lenders. Any alternative approaches to the masking of credit files, including temporary markers, would need to be effective and responsive to a range of circumstances in the future.

As part of this, the FCA should work with industry and consumer groups to set out clear outcomes for what reporting of arrears, default and forbearance should achieve for lenders and consumers in both the short-term and longer-term.

Looking forward, the picture is complex but regulators and government need to prepare for the full financial impact of Covid-19 to continue to bite

2.20 The original measures introduced by the FCA have largely been extended and rolled forward. Looking ahead, the FCA will need an approach that recognises the long-term nature of the crisis and that the effects will continue for a significant period for some people.

2.21 The shape of the credit market over the next few years, in terms of supply and demand, will depend largely on the wider economic environment. A stronger economic recovery would drive consumer confidence, making people more willing, and able to, access credit for a range of reasons. In a more challenging economic environment, some consumers may seek to shore up their finances. Where consumers minimise expenditures and repay debt, this will drive down the demand for credit. However, rising unemployment and pressure on earnings is likely to increase demand for credit from some consumers whose household budgets are under pressure. Overall, demand from vulnerable and low-income groups would likely increase, while overall demand would likely fall due to reduced consumer confidence. Further, all of this is underpinned by how far changing patterns of consumer expenditure will persist once public health conditions allow for society to return to more normal patterns.

2.22 On the supply side, a more challenging environment would reduce lender confidence. Increased risk of impairment may make firms less willing to lend to new consumers while making their existing books riskier, leading to more resources being placed around forbearance and reserves. This all places a downward pressure on lending. In some cases, smaller or more precarious firms may not survive. Where lenders leave the market, or reduce their lending levels, demand may shift from these lenders to their competitors or to different credit products.

2.23 It is likely that we will be in such a challenging environment, at least in the short term. The Office for Budget Responsibility is projecting falls in disposable household income for 2021 before a reasonably strong recovery in 2022 onwards. There is scope for consumer harm to occur from: (a) increased levels of vulnerability in those seeking credit, (b) changes in mainstream products, or treatment of existing consumers due to reduced demand and revenue in mainstream lending, and (c) continued reduction in supply across mainstream and high-cost lending meaning consumers in need of credit are not able to access it. Generally, where firms are less willing to take on new customers they focus on existing consumers. This raises the risk that activities such as pressure selling could be incentivised.

2.24 The FCA's response to the crisis, alongside the wider package of measures provided by the Government and other regulators, will have allowed many consumers to recover from the short-term impacts of the crisis, seeing them through a period of uncertainty. For others, however, these interventions will have only delayed the financial impact of Covid-19. The ongoing recession will also see more consumers fall into difficulty for the first time since the start of the pandemic. Measures introduced by government and other authorities, including job support schemes, deferral of council tax and a temporary ban on evictions, have had a similar effect. Many of these measures are scheduled to fall away during 2021 at a time when financial difficulties could be growing.

2.25 These circumstances make it inevitable that more people will struggle to meet their credit payments. They will need support from their lenders through effective forbearance. Lenders also have an important role in helping consumers take steps to better understand and improve their financial situation. Where consumers are willing and able to self-help, rather than using formal debt advice, firms should help support this. Where consumers could benefit from debt advice, firms should have formalised and effective referral strategies. The FCA has issued guidance to lenders on both tailored forbearance and the role they can play around money guidance and debt help. FCA supervisors are monitoring this. It is critical that the FCA maintains attention on these issues during 2021, including taking swift action where required.

Recommendation 2

In 2020, the FCA acted decisively by fast-tracking the policy process for critical pieces of work to respond to the emerging risks created by the pandemic. This allowed the regulator to be proactive and shape an evolving economic environment. The crisis and its impact are continuing into 2021 and the FCA must continue to act in a similarly decisive and rapid way where it identifies emerging harms. This should include work set out in Chapter 5 to create a more prescriptive and consistent approach to forbearance, so that consumers in financial difficulties can benefit from this as quickly as possible. The FCA should also consider whether action may be needed to deal with emerging harm related to access to credit, treatment of existing consumers and increased levels of vulnerability of borrowers as a result of the pandemic.

2.26 Free debt advice plays a critical role in a healthy credit market, helping consumers to build a picture of their financial position which creditors can rely on, coordinating between multiple creditors and recommending suitable debt solutions. This can help consumers recover from financial problems and rebuild their financial resilience. Support to help deliver debt advice is not only important for consumers. It is also beneficial for the wider economy and creditors. The crisis has highlighted this while also bringing into focus known problems in the supply of free debt advice and the way it is funded. This year will also see the introduction of the government's Breathing Space scheme and there are plans for the introduction of a Statutory Debt Repayment Plan (SDRP). The combination of Covid-19 and new statutory debt solutions such as SDRP has the potential to change the debt advice and debt solution landscape and there is a case for taking this opportunity to look at how the sector works as a whole and how it can best deliver for those most in need.

2.27 Historically, the free debt advice sector's capacity has been significantly lower than demand. Research by the Money and Pensions Service (MaPS) in 2019 indicated that debt advice providers only had capacity to meet 41% of the demand for debt advice. During the early stages of the crisis, the government, the MaPS and debt advice providers took steps to prepare for an expected spike in demand for free debt advice. The reduction in people's incomes caused by the crisis also led to people on debt management plans (DMPs) reducing their monthly repayments. Consequentially, there was a significant reduction in revenue for debt advice providers providing DMPs (funded through the 'Fair Share' mechanism). In July 2020, the Treasury announced an additional £37.8m of funding to support the sector in England through the MaPS and an additional £5.9m for the devolved authorities. These funds were to allow the sector to maintain current levels of advice, enable more advisors to work remotely, deliver debt advice for an additional one million people above the existing 580,000 (in England) already committed to in 2020-21 and to develop and procure digital advice tools.

2.28 Estimating how consumers will turn to debt advice is difficult to do. Simply multiplying the increased by a factor of those in greater difficultly could suggest a number as high as 2.5 m, but taking into account the significant increase in trained staff in lenders, greater automation in dealing with arrears and the estimates from debt charities and made by the FCA, a range of 1-1.5m additional demand for debt advice sessions would seem more reasonable. How this demand will present itself and over what timetable is less certain, but the debt advice sector will need to plan for this demand and have the capacity to meet it. The additional funding made so far suggests this is can be done, but it will be tight.

2.29 The 2018 Wyman Review identified issues around Fair Share and the need for extra funding to enable capacity to meet demand. In early 2020, a joint FCA/MaPS review considered options for new long-term funding models for the sector which could provide a basis for future action. There are also long-held concerns around fairness in how debt advice is funded. Financial services are the only sector to be compelled (through levies) to fund debt advice, despite debt advisors increasingly dealing with debts linked to utility bills or to local government. In particular the absence of for-profit utility providers funding the debt advice sector is unfair.

2.30 The demands on debt advice due to Covid-19 are likely to last for many years, creating additional pressure on the sector's funding and structure. The additional funding and growth of the sector in the short-term because of the crisis provides an opportunity to consider the longer-term structure of the sector. This should include ways that funding arrangements, especially where funding is from commissioners such as MaPS and the devolved authorities, can be structured to give debt advice providers clarity on their budgets over several years so they can plan and invest for the future.

Recommendation 3

Although action taken by the government and the FCA reduced the immediate impact of Covid-19 on consumers, Covid-19 will leave many open to financial shocks for some time to come, increasing the demand for debt advice. The FCA should work with MaPS, government and any other agencies to ensure that there is a long-term, multi-year strategy in place. The sector needs to be securely funded to meet the demands of the pandemic and this is an opportunity to place the not-for-profit sector on a more sustainable footing in the long-term, particularly through the use of multi-year funding settlements. The FCA should actively support the efforts of MaPS to place the free debt advice sector on a strong, sustainable and fair financial footing.

2.31 Debt advice is ultimately a means to an end. So it is important to focus not only on the availability of advice but also availability of suitable solutions and paths to recovery. Several respondents to the Review raised concerns around the functioning of the Individual Voluntary Arrangements (IVA) and Protected Trust Deed (PTD) markets, neither of which is regulated directly by the FCA. They asked whether the often high and front-loaded fees for these solutions were driving poor outcomes and practices for both consumers and creditors. The message from these respondents, including both consumer advocates and creditors, was clear: the IVA market is broken. Insolvency Service statistics show that there has been an increase in the IVA failure rate in recent years and the percentage of IVAs failing within the first year has increased to the highest percentage since 2002. While this lies outside the FCA's remit, it has an impact on areas within it. High levels of commission - sometime over £1,000 per referral - have driven potentially harmful business models in the regulated debt advice sector as well as the unregulated lead generator sector. This can lead to more holistic and free debt advice providers being crowded out from search engine results, making it harder for consumers to find the best advice provider for their needs. The government issued a call for evidence in 2019 on whether changes are needed to the regulatory framework for the insolvency profession and a response is expected this year.

2.32 These issues are not limited to IVAs and PTDs. Fee-paying debt management plans raise similar concerns, although in this case there are limits on the fees which can be charged and FCA rules do not permit the front-loading of fees. There is a clear need to ensure that the debt solution market works to deliver consistent outcomes for consumers, regardless of what solution is best for them or who regulates that solution. This should include considering consumers with low or negative disposable income whose finances may limit their ability to access all debt solutions even where these will be in their best interest. In the case of Debt Relief Orders (DRO), which are only available for individuals with disposable income less than £50 a month, the fee of £90 presents a significant barrier to uptake. The expected high level of demand for debt advice in 2021 will translate into increased need for debt solutions and it is critical that people are able to access the most suitable solutions. Immediate steps should be taken to ensure that the debt solution market can support demand and barriers to access are reduced.

Recommendation 4

Measures introduced by the government and the FCA have provided an essential, but temporary, support to people affected by the pandemic. For some, the economic impact of the pandemic has been severe, will not be temporary, and there will be increased need and demand for suitable debt solutions to help them recover. To ensure that the imminent demand for debt solutions as a result of the pandemic is met, the FCA must without delay coordinate with the UK government, devolved administrations and insolvency regulators to ensure that suitable debt solutions are available to best serve people in financial difficulties. This should include identifying quick actions to remove or reduce barriers to accessing suitable solutions (including fees) and steps to reduce consumers being driven towards unsuitable solutions (including the role that marketing plays in this).

Recommendation 5

Across the UK there are multiple regulators covering different aspects of debt advice and debt solutions and it is essential that this does not lead to divergent outcomes for consumers who are in financial difficulties. The FCA, Insolvency Service and Accountant in Bankruptcy (Scotland), with support from government, must cooperate to swiftly remedy the issues that can be observed in the Individual Voluntary Arrangement (IVA) and Protected Trust Deed (PTD) market. This should include close attention to problems created by the fee structure of IVA/PTD products on debt advice and lead generators. In the longer-term, the FCA should collaborate with these bodies to create a coherent and consistent vision of the debt solution market and a plan to bring this about

Recommendation 6

People with significant debt problems and low or no disposable income have few options available to them. Debt advice for these people is more complex and costly as a result. To enable the debt advice sector to operate efficiently at a time when it will be under significant strain, barriers should be reduced to people accessing suitable debt solutions. In particular, it is unfair when the very poorest are asked to provide £90 for a Debt Relief Order (DRO) application. The FCA should discuss with the government how an emergency fund could be provided to cover the cost of the DRO application fee for people who cannot afford the fee but who would benefit from the solution. This could be delivered to the poorest clients through debt advice providers where they act as DRO administrators, as they have sufficient information to assess if an individual would be able to afford the fee or not. Alternatively, of course, government may wish to consider if the fee itself could be amended, waived or reduced, but like other fees is based on a cost-recovery basis.

3 Access to credit

3.1 Consumer access to credit depends on a number of different factors. The cost of credit and what's affordable, the availability and quality of credit information to allow lenders to assess consumers' creditworthiness, and consumer awareness of available credit options.

3.2 Most UK adults will have access to a variety of unsecured lending products at a range of different price-points and will be able to decide what they want to use. There will be others who will struggle to access a variety of credit products and whose choices will be limited to alternative solutions, including high-cost lenders or the community finance sector. Access may be limited for those who find it hard to evidence their creditworthiness. This includes those with poor credit histories who may have been in financial difficulty or those with thin or no credit files, which can include younger people, those who are self-employed, or are new to the UK. In an increasingly digital society, people who don't have access to technology may also miss out on accessing a full range of credit options.

3.3 Fair 4 All Finance estimates there are 11 million people in the UK who need support in accessing cheaper or more sustainable forms credit. This includes 3 million who are stuck in persistent debt and 4.5 million on stable but low incomes.

The credit journey

3.4 As noted in Chapter 1, a healthy credit market should include a suite of options, including sub-prime, near-prime and prime credit products. Consumers who consistently repay on time and demonstrate they can manage their finances should have access to the greatest range and cheapest options.

3.5 Those who have been in financial difficulty, but who can demonstrate through consistent repayment they have recovered, should be able to transition from high-cost back to lower-cost forms of credit. Respondents to the Review highlighted that those who use high-cost credit should not be stigmatised; with evidence of consistent repayment and repayment of outstanding debts, they should be able to rehabilitate themselves and have access to a wider range of credit products.

Products designed to 'build' credit scores ('low and grow')

3.6 There are already products on the market which claim to be 'credit builders' or 'low and grow' products. They advertise themselves as supporting consumers to improve their credit scores and ultimately transition to being able to access cheaper forms of credit. Respondents to the Review have shared their doubts about the effectiveness of these products; whether credit scores and access improves through using them and if the transition from high to low-cost credit is being enabled.

3.7 These products are particularly common in the credit card market, but also increasingly seen in the wider lending market. An individual with a thin or poor credit file is granted a small line of credit, and if they manage to successfully repay this, are granted a bigger credit limit in future. From a lender perspective this helps manage risk, and also takes borrowers to a point where they are borrowing enough to be profitable as a customer.

3.8 These products can be controversial and are seen by many consumer groups as a pathway into debt. The FCA looked at the 'low and grow' practice as part of the Credit Card Market Study (CCMS), noting these products compete on risk appetite, offering greater access to credit than other competitors. The CCMS didn't identify any specific harms unique to these products.

3.9 Nonetheless, there are potential risks attached, including their suitability and the care needed to manage consumers who use them throughout the lifetime of the product. The Financial Ombudsman Service (FOS) has recorded a number of decisions against lenders where they took insufficient care with repeat users whose amount of debt was growing.

3.10 Products or business models which aim to help consumers bridge from sub-prime to near-prime or mainstream have an important role to play in expanding access to credit, and consumers value them as an option. The CCMS highlighted that 36% of consumers who had a 'low and grow' product chose it specifically to improve their credit history. This makes it vital that products which are marketed as 'credit building' are effective.

3.11 The FCA's Sandbox initiatives are designed to support innovation within financial services. Cohorts are designed around certain themes, with firms able to test their propositions in the market with real consumers. As such, the Regulatory Sandbox should consider whether to include 'credit builder' products as part of a future cohort, to encourage further innovation in this area.

Recommendation 7

Consumers who have experienced financial difficulties and have poor credit files struggle to access a wide range of credit options. These consumers need products which not only offer a suitable and sustainable source of credit, but which are designed to help them to improve their credit files and build financial resilience. The FCA should:

- Conduct work to identify whether 'credit builder' products currently in the market are effective in supporting consumers to access a wider and cheaper range of credit products. If these products aren't found to be effective, the FCA should take steps to limit use of terms like 'credit building'.
- Include a theme on a future cycle of the Regulatory Sandbox to accelerate the growth of products which support consumers to transition from high to low-cost credit and increase their financial resilience.

Community credit providers

3.12 As noted above, a healthy credit market should include a range of credit options. The FCA's Alternatives to High-Cost Credit Report highlighted that those who struggle to access mainstream credit should have access to alternatives to high-cost credit. For those consumers, high-cost credit may be unaffordable and lead to poor outcomes.

3.13 Community credit providers, such as credit unions and community development finance institutions (CDFIs) are important providers in the alternative credit market in some localities. Nonetheless, both face barriers to growth and sustainability, often struggling to compete with larger, commercial lenders. This Review has therefore considered how community credit providers could widen their offering or how gaps in the availability of alternatives could be addressed by an increase in commercial market participants.

Credit Unions

3.14 According to the Bank of England and FCA, in 2019, there were over 400 credit unions lending around £1.6bn to over 2m members across the UK. Credit unions registered in Great Britain are subject to the Credit Unions Act 1979, whilst those registered in Northern Ireland are subject to the Credit Unions (Northern Ireland) Order 1985. This legislation sets out what credit unions can do and limits their activity to fulfilling certain statutory objects. They offer an important alternative to consumers who cannot get mainstream credit as well as access to a wider range of financial services than consumer credit, including savings and mortgages.

3.15 Legislation caps the amount of interest credit unions can charge on loans (equivalent to around 42.6% Annual Percentage Rate (APR) in Great Britain and 12.9% in Northern Ireland). There is a question about whether the cap on rates allows credit unions enough room to fully serve the sub-prime part of the market. CDFIs aren't subject to the same cap and so reflect the risk in the cost of credit they provide, with loans offered typically in the high double-digits, but also at rates above 100% APR, and in some cases over 200% APR.

3.16 The government and devolved administrations have taken steps to encourage increased membership and growth of credit unions, recognising the valuable role they play. These include:

- The Affordable Credit Challenge supporting partnerships between community lenders and financial technology firms to develop innovative solutions to help increase access to affordable credit.
- The prize-linked Saving Scheme which incentivises credit union members to save a certain amount in an eligible credit union account with the chance of winning a cash prize.
- The government commissioned feasibility study, published in 2020, on a no-interest loans scheme (NILS), and its subsequent work with stakeholders towards a pilot. A no-interest loan scheme would provide access to credit for those who may struggle to pay anything more than the principal of a loan.
- The Scottish government's £10m Credit Union Investment Fund with the aim of assisting credit unions to grow and help more people to save and borrow.
- The Welsh government has established a scheme during Covid-19 to enable those living in private rented accommodation, who have fallen behind with their rent, and are at risk of being evicted, to apply to a credit union for a low interest rate loan to clear arrears. This scheme is underwritten by the Welsh government.

3.17 But more work is needed to create a sustainable and growing credit union sector. Respondents to the Review have called for the liberalisation of credit union legislation to increase the variety of products which credit unions can offer and which would, in the long-term, increase the sustainability of the market.

3.18 Both pieces of credit union legislation are over 35 years' old, the market has evolved and there is a growing need for consumers to have access to affordable credit. Credit unions are restricted to offering only what has been set out in legislation and that is now becoming one of the main barriers to growth. To help address gaps in the alternative credit market and encourage expansion and greater sustainability, legislation should be revised to allow them to provide a more holistic service.

3.19 An integral part of any question about the commercial strength of the credit union sector has to include governance, the common bond, and whether the smallest credit unions can, or want to deliver the modern mission required of them. This raises the question of whether there should be more consolidation in the sector. It also raises the question of whether a two-tier system may be appropriate. Those credit unions that aspire to be primary financial institutions, with the ability to offer a wider variety of services, would need to meet more stringent regulatory requirements. Whereas smaller credit unions who can't or don't want to offer a range of services wouldn't need to meet those same requirements.

Recommendation 8

Credit unions offer an important alternative to high-cost credit and enable wider financial inclusion. To fully realise their potential there is a case for removing some of the current restrictions on their activities. The FCA should work with the Bank of England, Treasury and Northern Irish government to set the timetable on updating the Credit Unions Act 1979 and Credit Unions (Northern Ireland) Order 1985 to allow credit unions to expand their product offering.

Community Development Finance Institutions (CDFIs)

3.20 CDFIs are not-for-profit lenders providing credit to individuals, small business and social enterprises who find it difficult to access credit from mainstream lenders. Established for social purposes, they are usually rooted in the local community. Most focus on lending to small business with only a small number providing consumer loans. Most offer some form of financial education as well as money and debt advice. Because CDFIs service a segment of the market which is outside the risk appetite of mainstream lenders and even some high-cost lenders, their target consumer market is relatively high-risk with a corresponding risk of default.

3.21 As CDFIs don't collect or hold deposits they rely on local authority or government grants and philanthropic support. Their overhead costs are comparatively quite high and their loans are usually for small sums. Most CDFIs are not self-sustaining and they struggle to attract the necessary investment to expand their activities.

3.22 As a result, the effectiveness of CDFIs to address the gaps in demand is limited. They need to balance sustainability with the high-costs inherent in their business model, all the while ensuring their interest rates remain below that of high-cost credit providers.

Recommendation 9

As with credit unions, community lenders offer a valuable alternative to high-cost credit. They should be encouraged to grow or subject to regulatory change, combine with credit unions. The FCA, the Treasury and Responsible Finance should report on ways to increase the lending capacity of Community Development Finance Institutions (CDFIs), for example, through subsidies or the development of investment incentives.

Barriers to entry for commercial providers of alternative credit

3.23 Credit unions and CDFIs alone are unlikely to address the needs of the market for alternative products to high-cost credit. Despite this there are few commercial providers entering the market offering alternatives. Respondents have provided input on the barriers to entry they've observed.

- New entrants can struggle to secure funding. This is because investors are nervous about regulatory uncertainty, the perceived high burden of regulation and the penalties for accidental non-compliance.
- Investors and mainstream lenders worry about the reputational risk of offering anything other than low-cost mainstream products due to the negative impact it can have on their wider brand.
- Without economies of scale, the higher costs of lending to sub-prime consumers, especially where relatively small sums are being lent, is not profitable enough to encourage entry from commercial firms without interest rates comparable to high-cost credit.

3.24 The first two of these barriers are, to a large extent, about perception. The issue of regulatory uncertainty was often raised to the Review alongside concerns with the approach taken by the FOS in its judgements on affordability. This is discussed in more detail in Chapter 5, where the importance is set out of the FCA and the FOS taking clear and public steps to clarify the regulatory environment and to reduce uncertainty.

3.25 The fact there has been poor conduct, and therefore strong regulatory action, in the sub-prime sector may have made firms averse to entering this market. Coupled with the significant focus on the pricing of credit, a situation has emerged where mainstream lenders are reluctant to lend, or fund other lenders, where the APR is above 40% or 50%. It is critical the conversation balances both price and the delivery of lending services which meet consumer's needs.

3.26 Mainstream lenders, with their economies of scale, experience and expertise could play an essential role in offering alternatives to high-cost credit. By entering the market, they could help address gaps in supply and encourage greater participation within the market. Many have the resources and infrastructure to ensure consumer demand is better met, affordability is properly assessed and support consumers should they get into difficulty. They could also help consumers transition to lower-cost mainstream credit products, particularly those with thin credit files, via the provision of basic bank accounts with interest free overdrafts or providing small loans at affordable rates. Encouragement could also be given to small scale saving, as a major UK bank was able to prove in its test in the FCA's Regulatory Sandbox.

3.27 There are already examples of mainstream lenders providing philanthropic support to alternative credit providers. Lloyds Banking Group, for example, has provided £6m to the Credit Union Development Programme. Although community lenders play an important role in providing certain consumer groups access to alternative forms of credit, there will always be a limit on their reach.

3.28 Without mainstream lenders entering the alternative credit market themselves, it will be difficult to address existing issues around the availability of alternative forms of credit. Nonetheless this Review recognises there are currently few incentives for mainstream lenders to enter the market and many are discouraged by the potential reputational impact of offering anything except low-cost credit. The market needs early entrants who are willing to lead greater participation by mainstream lenders.

3.29 In December 2020, Fair 4 All Finance announced its refreshed strategy which included a priority focusing on partnering with banks and financial services providers to provide better outcomes for consumers in vulnerable circumstances.

Recommendation 10

To date, mainstream lenders have been reluctant to offer or fund alternatives to high-cost credit. Greater involvement of these lenders directly in non-prime credit markets, with their expertise and economies of scale, is essential to driving competition and innovation. Consumer choice and outcomes will likely remain limited without this. The FCA in collaboration with the Treasury, Fair 4 All Finance and leaders from industry, should convene discussions with mainstream lenders on their participation in providing alternatives to high-cost credit. These discussions should seek to find ways to overcome the barriers (eg regulatory and reputational risks) to entering this market.

Consumer awareness

3.30 Consumer awareness is critical. A key barrier to accessing credit is consumers not knowing what options are available. Research commissioned as part of this Review illustrated that consumer understanding of different credit products varies significantly. Consumer understanding and use can often be based on advice from friends, family and colleagues, rather than seeking professional advice. Data shared with the Review indicated that if rejected for a mainstream credit product, nearly a third of consumers wouldn't know what alternatives are available to them and report that they 'feel helpless'.

3.31 Consumers can underestimate the credit available to them and, for fear of rejection by lower-cost providers, dismiss mainstream lending options altogether. This can lead to them turning to more expensive forms of credit than perhaps they need to or even to credit that is provided illegally. Several respondents to the Review highlighted that providing information to consumers about alternative forms of borrowing could constitute credit broking, especially when referring to specific local or community lenders. This could result in missed opportunities for giving timely information to consumers. The FCA has acted in this area before, working with Treasury to create an exclusion for Regulated Social Landlords (RSL). The FCA also published guidance in December 2018 which set out guidance for RSLs on what would constitute credit broking.

3.32 The credit broking sector, which functions to connect potential borrowers with a range of lenders, has a clear role to play here. This is particularly clear where brokers also act as credit information service providers and offer consumers access to their credit information, together with ways of improving their credit score.

Recommendation 11

Consumers can not benefit from greater availability of alternatives to high-cost credit if they are not aware of them. Many consumers use forms of credit which they see others around them using and steps will be needed to effectively raise awareness of alternative products. The FCA should work with Fair 4 All Finance to identify and address barriers preventing consumers having a better awareness of alternative credit products. Where there are regulatory barriers the FCA should seek to remove them where appropriate.

Recommendation 12

There is change and innovation in illegal money lending, including through online platforms. It is essential that consumers are aware of the risks from illegal money lending in the same way as the FCA has acted around investment scams. The FCA should work with the English, Scottish and Welsh Illegal Money Lending Units, The Northern Irish Consumer Council, industry participants and debt advice charities to increase consumer awareness of the risks of engaging with illegal money lenders. As part of its wider work on fraud with online search firms the FCA should explore removal of illegal online lenders from search results.

Limiting the volume of high cost credit

3.33 As well as the measures noted above, steps can also be taken to limit the need to seek high cost credit in the first place. This can include small-scale saving schemes like the ones pioneered by the Money and Pensions Service (MaPS), the government's no interest loans pilots or help to save scheme. However, many of the poorest and most urgent cases will involve individuals or families with no meaningful savings.

3.34 As noted in Chapter 1, some respondents to the Review also highlighted that the design of social policies like Universal Credit can also drive the need for high cost credit or other borrowing that can cause income instability.

3.35 The Review does not aim to examine in detail the complex interactions between social policy and the credit markets. It is also for government, and not the FCA, to set social policy measures. However, these interactions exist and it is important they are fully understood and, where possible, steps are taken to reduce poor outcomes.

Recommendation 13

Looking at the credit market from a holistic perspective the biggest potential harms occur where there is a need for those on lower incomes or benefits to borrow. In the preventative space, as well as affordability and repeat lending guidance (see Chapter 5), the FCA should provide government with evidence and analysis on the impacts of different social policies, including Universal Credit, on the demand for high-cost credit so that government can identify ways to reduce consumer harm in this area.

Credit information

Role of the credit information market

3.36 Historically, the credit information market developed as a business support service, whose end customers were lenders (rather than borrowers). This is still largely the case. The provision of tools to assist identification and income verification, credit references and analytic tools assists lenders to make commercial decisions. The presence of third party providers of high-quality, trustworthy and predictive credit information is a critical part of a modern credit market.

3.37 While Credit Reference Agencies (CRAs) are not responsible for lending decisions themselves, it is no longer the case they are simply part of the background. Consumers have become increasingly aware of the importance of their credit files in many parts of their lives, not only credit. As a result, they may look to actively modify their behaviour to improve their credit scores or limit damage to their files. CRAs have responded to this by giving consumers easy access to 'educational credit scores' and there has been growth in the number of credit information service (CIS) providers, who take data from CRAs and then present it to consumers, often along with tips for how to improve their score. This is sometimes coupled with credit broking services. As a result, the credit information market is increasingly one in which consumers are engaging directly.

3.38 The credit information market clearly also has an impact on consumer outcomes, even when this is mediated through lenders. As such, they serve a public (and not just commercial) function. The way that credit information is collected, submitted and processed affects lending decisions and access to credit, as does the development and availability of new analytic tools such as those linked to Open Banking. This has been clearly recognised during the pandemic, with 'credit masking' being used to address the concern that short-term financial difficulties might lead to long term problems due to the impact on consumers' credit files.

3.39 As discussed in Chapter 2, this has raised questions about whether there is enough nuance in the way firms treat arrears, forbearance and debt solutions. This is important as it affects the long-term impact of financial difficulty on consumers and their path back to full financial resilience and inclusion. The point is more general than purely the pandemic: the credit information market must play a role in delivering the right outcomes in healthy credit markets. However, it is not clear that a market driven solely by commercial interests would deliver those outcomes. Regulators have a vital role in identifying how credit information can support a healthy credit market and driving forward a strategy which delivers this.

3.40 Several respondents to the review highlighted that the credit information market can be slow to implement changes where they are needed, a point acknowledged by the CRAs themselves. Problems with legacy infrastructure and concerns about the knock-on effects of any changes in reporting were often cited as the root of the problem. This is not only about CRA systems but also the shared responsibility of the systems of lenders who need to both submit and receive credit information. This is an area where a step forward is needed so that infrastructure does not limit innovation.

Improving the quality of credit information

3.41 A key factor around access to credit is the availability and quality of credit information. Respondents highlighted that limitations on data availability can lead lenders to both include and exclude consumers inappropriately. Inconsistencies between CRAs also mean firms may need access to more than one provider. Respondents therefore called for greater consistency and transparency of the credit information market.

3.42 For most lenders, there is currently no regulatory requirement to share information with CRAs. As such, there is a question of whether introducing a mandatory reporting requirement on all lenders would improve consumer outcomes. This would address calls for greater transparency of innovative credit products entering the market (particularly Buy Now Pay Later offers). It may also drive CRAs to re-consider how they compete for business, encouraging them to compete more on the quality of their data analysis.

3.43 This has the potential to drive better outcomes in the credit market. Lenders would not only have access to more data, but potentially higher-quality analysis, which could enable them to make more accurate affordability assessments. Getting data from multiple CRAs is expensive for lenders, and the trade-off between this cost and getting a full picture of a borrower's credit position is potentially harmful for consumers.

3.44 It is also important that the information which is provided to CRAs is high quality and up-to-date. This is not limited to data which is provided by lenders, such as whether customers are repaying their debts on time and in full, although there may be a need for greater consistency in how different CRAs provide this data. Lenders also get credit information from other sources and the quality of this information matters too.

3.45 An important example is information on County Court Judgements (CCJs) obtained by creditors as part of their enforcement process. CCJs can have a significant impact on a consumer's credit file, limiting their access to credit. Respondents pointed out that many consumers may not be aware that they have a CCJ against them, for instance where they have changed address and did not receive the notification. This means that even if they repay the debt they do not know to inform the Court that the debt is satisfied and so the CCJ remains on their file.

3.46 However, creditors are in a position to know both that a CCJ has been taken out and whether the debt has been settled. It would therefore seem appropriate and efficient for creditors to bear the responsibility of informing the Courts where debts have been settled. This would improve the quality of credit information and outcomes for both consumers and lenders.

Open Banking and other alternative data sources

3.47 A key driver of credit information is to find new, informative sources of data and Open Banking is driving most of the innovation in this market. Open Banking has the potential to help address some problems in the existing credit information market, helping to fill gaps for consumers with thin credit files or who are self-employed. Open Banking data also has the potential to reduce operating costs by allowing firms to make more accurate lending decisions and could thus encourage more new entrants to offer alternative forms of credit.

3.48 Nonetheless, there is still some way to go before all lenders can access the benefits of Open Banking data. Many community lenders may not have the expertise to analyse the data and will therefore require access to effective and affordable analytics tools. Open Banking data also relies on consumer consent. Given the just focus on the security of personal information to protect against fraud, some consumers are cautious about giving consent for their data to be used. Both these barriers will need to be overcome to allow Open Banking to reach its full potential.

3.49 Respondents to the review highlighted that Open Banking isn't the only potential alternative information source to traditional CRAs. They suggested a number of datasets which could help lenders make more accurate lending decisions, including Her Majesties Revenue and Customs (HMRC) data, Department of Work and Pensions (DWP) benefits data or council tax or student loan payment history. However, there is currently no plan or provision to allow lenders access to these datasets and it would require the creation of new information channels.

3.50 More research and evidence is needed around supply-side and demand-side enablers for Open Banking to support better outcomes for consumers.

3.51 In addition to cutting edge technology, there is scope to explore the impact of other assessment tools to judge risk such as maths skills (particularly for those assessing thin credit files) and also the impact of how numbers are presented in disclosures to borrowers to help them make better decisions as advanced by National Numeracy and Plain Numbers.

Recommendation 14

Credit information plays an essential role in supporting good outcomes in lending markets. Access to credit is often dependent on the availability of high-quality credit information and changes in the way that information is recorded can take a long time to implement. Through the Credit Information Market Study or as part of a wider strategy, the FCA should:

- make clear the outcomes which the market needs to achieve for consumers and lenders, and how these will support a healthy credit market, including where consumers interact directly with Credit Reference Agencies (CRAs) and Credit Information Services (CISs)

- assess whether the credit information market is operating is a way which enables consumers who use credit responsibly to build their credit file and access more credit options
- consider whether a mandatory reporting requirement would drive better outcomes for consumers
- consider the case for introducing rules to require creditors to report to courts when a County Court Judgement (CCJ) has been satisfied or partially satisfied, to drive up the quality of existing credit information
- identify and address barriers to widespread use of Open Banking data, with particular attention to alternative credit providers

Recommendation 15

The standards around how credit information is submitted and shared have developed over time and with little regulatory oversight or direction. Legacy infrastructure is regularly cited as a limiting factor in making changes to how information is reported. The FCA, working with the Steering Committee on Reciprocity (SCOR), lenders and consumer groups, needs to:

- consider whether the current governance arrangements deliver good outcomes and to implement new arrangements if not
- identify areas where legacy infrastructure is creating barriers to change and innovation in the credit information market and set out a timeline for improving or updating systems.

4 Innovations in the unsecured credit market

4.1 The unsecured credit market is highly dynamic with a large number of innovative firms and business models. Considering innovation in the market, the review has looked at:

1. The growth of digital technology to support firms
2. Buy Now Pay Later (BNPL) products that are currently outside the FCA's perimeter
3. Employer Salary Advance Schemes (ESAS)

4.2 Throughout this review, 'BNPL' refers to unregulated BNPL credit agreements which rely on the exemption found in Article 60F(2) of the Regulated Activities Order (RAO). Where we refer to BNPL which falls within the FCA's remit, this will be specifically called-out.

4.3 We chose to focus on BNPL and ESAS because they both have the potential to disrupt the existing unsecured credit market by offering low or zero cost alternatives to mainstream or high-cost credit.

What these products have in common

4.4 Although very different products, BNPL and ESAS do share some similarities:

- Both purport to offer fast, simple ways to help consumers access alternative credit or credit-like facilities. BNPL allows consumers to either delay paying for items or spread the cost of purchases. ESAS help consumers to smooth their income across their pay cycle by giving them access to a percentage of their earned wages before payday.
- Providers of these products tend to be relatively new and are often predominantly technology-driven, focusing on utilising digital platforms to provide seamless consumer journeys.
- Providers partner with third parties (retailers for BNPL and employers for ESAS) to give consumers access to services which help them manage their finances, without having to undertake detailed or formal application processes.
- These products are often seen by consumers with a poor credit history or thin credit files as a viable alternative to more traditional forms of regulated lending.
- Consumer awareness and understanding of these products varies widely. Consumers aren't sure whether either product is credit. Some view them as a financial service and therefore think they come with the rights and protections of a regulated product.

4.5 This review is an opportunity to step back and reflect on these two innovations and consider what, if any, action the FCA should take for each product.

4.6 To help the Review understand consumer perception of these products, the drivers of use and potential harms, qualitative consumer research was commissioned. Over 40 participants from across the UK took part in the research, which involved 8 focus groups and 6 in-depth interviews.

The growth of digital technology in the provision of consumer credit

4.7 Like all financial services, the unsecured credit market is evolving and innovating. What used to be paper-based or face-to-face transactions are now more commonly completely digital. Entire consumer journeys can now take place without the need for human intervention with pre-defined algorithms making lending decisions.

4.8 Covid-19 has accelerated the trend towards digital as consumers stayed at home and used their personal devices. This review has heard from providers that lenders who previously relied predominantly on in-person transactions and have now adapted to largely digital business models.

4.9 Many of the innovations seen in the consumer credit sector have either focused on how technology can improve the consumer journey or automate services. Open Banking data, for example, can be used to support a range of decision making.

4.10 The growth of digital technologies in the unsecured credit market has the potential to bring benefits for both firms and consumers. At scale, it can smooth consumer journeys, reduce the cost of providing credit and enable faster decision-making. Respondents to the review highlighted that digital tools can enable smarter, more tailored ways to give consumers key information.

4.11 Digital technologies also present potential harms. For example, respondents highlighted that although many will welcome smooth consumer journeys, they can pose a risk to those with some mental health conditions where impulse control is a problem.

4.12 Respondents highlighted that with the move to ease and speed, key information can get lost – either by design or unintentionally. Either way, it can have negative outcomes for consumers. As such, digital designers should prioritise consumer control and understanding when designing digital journeys. They should think beyond messaging which purely meets regulatory requirements and focus on ensuring consumers are able to make informed decisions. They should take specific account of vulnerable consumers and ensure journeys are designed to ensure they are able to remain in control of their decision-making.

4.13 There remains a risk that lack of access to data or devices will exclude vulnerable consumers from products that would be useful and should be available to them. According to the FCA's Financial Lives 2020 Survey, in the UK, 9% of adults (4.7m individuals) are digitally excluded. By digital exclusion we mean those who have never used the internet; have not used the internet within the last three months or don't know when they used internet last; or those who have used the internet in the last three months but less often than once a week and rate their ability to use it as poor or bad. It is important to ensure that group of consumers continues to have access to a wide range of credit products. Credit providers should therefore be aware of the risk of digital exclusion and consider how innovations may exclude consumers who do not or cannot access digital platforms.

Recommendation 16

The growth of online lending is one of the main areas of change in the credit market. Many of the features of digital platforms which some consumers find beneficial - such as smooth consumer journey, 24/7 access and not needing to interact directly with other people - can present problems for others. These problems are often enhanced when consumers are vulnerable. The FCA should ensure it has in place guidance for digital design in the consumer credit sector that focuses on good consumer outcomes, ensuring consumers are informed and remain in control of their decision-making. The FCA should consider updating its disclosure requirements to make them more suitable to a digital age.

Recommendation 17

The benefits of digital lending are not available to everyone. The FCA should continue to monitor digital innovations in the consumer credit market and ensure consumers who don't want to, or are unable to access digital platforms, aren't unduly excluded from accessing credit.

Buy Now Pay Later

4.14 Buy Now Pay Later (BNPL) is a broad term and covers a variety of credit agreements, some of which fall inside the FCA's perimeter while other types are able to rely on an exclusion. The FCA published rules in 2019 to provide additional consumer protection for regulated BNPL offers. These typically involve promotional periods of up to 12 months during which the consumer does not have to make payments and is not charged interest. Nonetheless, interest is charged if they do not pay the balance by the end of this period.

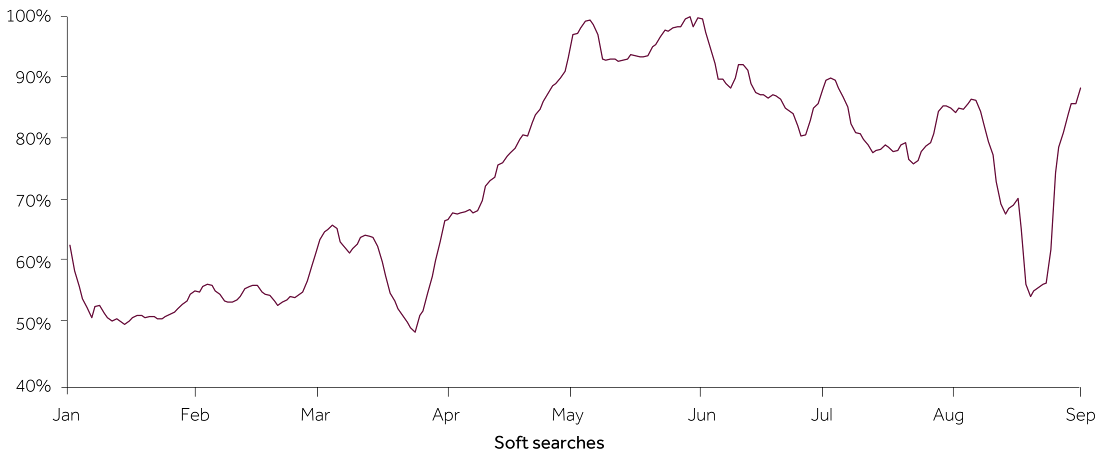
4.15 This review has focused on BNPL agreements which fall outside of the FCA's regulation. They often take the form of either deferred payment or short instalment loans. Before consumer credit was transferred to the FCA, the exemption was previously under the Consumer Credit Act 1974 (CCA), and had been in force since 1989. The exemption was limited to 4 payments within 12 months, but was increased to 12 payments on transfer to the FCA. These agreements now rely on the exemption in Article 60F(2) of the Regulated Activities Order (RAO). The exemption under the CCA was never intended for this kind of product but only for short-term invoice deferral. BNPL providers aren't the only firms that rely on this exemption. It's also used by a variety of non-financial firms that offer interest free credit, for example dentists use it for repayment plans and sports clubs for membership fees.

4.16 Business models usually rely on merchant fees paid by the retailer to the BNPL provider, based on a percentage of the order value. BNPL providers often market themselves to retailers on the basis that use of their offers increases consumer spending. Data provided by some BNPL providers indicates 25% of users are aged 18-24 and 50% are aged 25-36. 75% of users are female and 90% of transactions involve fashion and footwear. In most cases the service is free to the consumer, as long as repayments are made on time.

4.17 As these products do not currently fall within the FCA's remit, it has been difficult to estimate the scale of the BNPL market. Nonetheless, data shared with the FCA by some of the main providers shows that growth in the value of transactions using BNPL to spread the cost over multiple payments has grown significantly this year more than tripling, nearly quadrupling between January and December 2020.

4.18 There were also spikes in the use of BNPL correlating with the April and November 2020 Covid-19 lockdowns. A recent survey of consumers carried out by the FCA in December 2020 found that 11% of consumers (5m individuals) said they had used a BNPL product since the start of the Covid-19 outbreak. The main reasons consumers gave for this greater use since the beginning of the pandemic highlighted providers' focus on increasing consumer awareness of their offers and on the expansion in the number of partner retailers. Some consumers reported they were using BNPL products to manage their finances because of the financial distress they experienced during the crisis.

Figure 5 - The number of consumer searches for BNPL increased notably following first lockdown. The chart shows the one week rolling average estimate for 2020 with figures based on a sub-set of searches. Source: FCA Credit History Information Panel.



4.19 Nonetheless, it should be noted that the total value of transactions for the BNPL firms the FCA has engaged with, for the period January to December 2020 was £2.7bn. According to the Bank of England, this compares with approximately £246bn of consumer credit borrowing. Overall BNPL is around 1% of the total credit market, but has accelerated very quickly to get there and is still growing.

Summary of five providers of exempt BNPL credit agreements (non-exhaustive list)

Provider	Repayment	Soft Credit Check	Late fees
Clearpay	4 fortnightly instalments	No	For orders under £24, one late fee of £6. For orders over £24, fees are capped at 25% of original order or £36, whichever is less.
Klarna	Two options: Pay in 30 days or 3 monthly instalments	Yes	No late fees, will try to take funds after 7 days and again after a further 7 days. If payments remain outstanding, debt could be passed to debt collection agency.
LayBuy	6 weekly instalments	Yes	£6 after 24 hours, further £6 after 7 days. If payments remain outstanding, debt could be passed to debt collection agency.
Openpay	3-7 monthly instalments	Yes	£7.50 after 2 days, further £7.50 after 10 days, capped at £15. If payments remain outstanding, debt could be passed to debt collection agency.
Paypal	3 monthly instalments	Yes	£12

Benefits of BNPL products

'I always see it as 'try before you buy' rather than buy now pay later'
Alice, BNPL user

'It's ideal for the emergency purchases where you don't have the money now...'
Neil, BNPL user

4.20 When BNPL is provided to those who can afford to repay on time, it is a cost-free way to access credit easily. If repaid on time, it is significantly cheaper than most alternative forms of regulated credit. It can play a useful role as an alternative to higher cost borrowing for those who may struggle to access mainstream credit elsewhere.

4.21 Consumer research conducted as part of the Review highlighted how users like the simplicity of the product. They liked having the option to cheaply spread the cost of purchases and the ability to 'try before you buy'.

4.22 Many BNPL providers have apps which consumers use to track repayments. These apps often include notifications in the lead-up to repayment days which can be a useful summary of the customer's obligations to repay. Nonetheless, consumers report that it can be hard to keep track of their debt and repayments, particularly when they have commitments across multiple providers.

4.23 Most providers told us they have some kind of support for consumers in financial difficulty, either through the ability to 'snooze' payments for a set amount of time or, for those who have already missed payments, freezing late fees. Provisions across products vary significantly and it's not always clear to consumers what help is available.

BNPL products also have potential harms

4.24 While BNPL products have significant potential benefits for consumers, we have identified a number of potential harms.

Understanding of BNPL offers

4.25 Understanding of BNPL offers varies widely. Consumer research and responses to the Call for Input highlighted that some consumers don't view BNPL as credit and often more closely associate it with payment technologies such as Google Pay, Apple Pay or Amazon One Click. Consumer research participants said the placement on retailers' payment pages and references to 'zero cost' and 'new ways to pay', suggested equivalence to a debit card rather than a credit product.

4.26 Given this perception, there is a risk that consumers may not apply the same level of scrutiny to their decision-making as they would for other credit products, including consideration of the potential consequences of failing to repay. This risk is increased as the differences between these BNPL products are often not obvious to consumers when options are initially presented.

'The Amazon buy now button. That's exactly what it reminded me of'
Jeff, non-BNPL user

Consumers think they are protected

4.27 It is concerning that our consumer research showed consumers don't necessarily view BNPL offers as credit, although most still viewed it as a financial service. As a result, consumers in our research thought the product was regulated and came with the associated protections, including the ability to refer complaints to the Financial Ombudsman Service (FOS). This lack of clarity may affect consumers' ability to make an informed choice about whether they want to use the product.

'You take it for granted that they [financial service providers] all are regulated'
Neil, BNPL user

Presentation of the BNPL offers

4.28 In a sense, the real target customer of BNPL providers are not the borrowers, but the retailers with which they partner. Providers market themselves to retailers on the basis that consumers spend more when they use BNPL offers than they would paying by traditional methods. Klarna, for example, refers to 'increased conversion' rates (ie customers buying products) and anecdotally we have been told some BNPL providers are telling retailers they can increase their sales by up to 30%. As a result, retailers are willing to pay BNPL providers a fee which covers the cost of lending. When this works well all 3 parties benefit – customer, retailer and BNPL provider.

4.29 However, there is a risk that a strong relationship between the BNPL provider and retailer can be to the detriment of the consumer. It could result in the presentation of BNPL offers and the overall consumer journey being designed to drive sales without due consideration for the affordability of the commitment the consumer is taking on.

4.30 BNPL advertising often focuses on aspiration, tapping into consumer desire to live a certain lifestyle. In initial exploratory research, the FCA's Behavioural Economics and Design Unit found some evidence that the consumer journey design may, in many cases, play into consumers' behavioural biases. Examples include:

- **present bias** when presenting only the benefits of deferred payments before a sale and not making the potential implications as clear
- **availability bias** by presenting it as something 'everyone else is using' and making it appear similar to debit options
- **confirmation bias** by ensuring basic information on simple payment steps is at the forefront, consumers are likely to pay more attention to what they already know and not unfamiliar information on missed or late repayments

4.31 These biases tend to promote use of the product and sales for the retailer, but may – by design – make it more likely that consumers make impulsive decisions that are not in their best interest. We found these biases in consumers during our work on high cost credit, including on regulated BNPL products. Therefore, it would seem reasonable to assume they are present in consumers using unregulated BNPL products.

'Clearpay makes the value seem less because they say pay £150 now or £50 for 3 months and it sounds better at the checkout'
Alice, BNPL user

4.32 There have already been a number interventions designed to ensure consumers understand these offers amount to credit and aren't encouraged to use them irresponsibly.

4.33 The Committee of Advertising Practice (CAP) published guidance in December 2020 designed to prevent ads for these services misleading consumers, with a focus on ensuring consumers understand the service being offered comprises a form of credit.

4.34 Also in December 2020, the Advertising Standards Agency (ASA) banned several Klarna ads promoted by 4 Instagram influencers. The ASA concluded that in the context of the challenging circumstances caused by the Covid-19 lockdown, including the impact it may have on people's financial situation and mental health, the ads irresponsibly encouraged the use of credit to improve people's mood. It's essential BNPL providers adequately consider the impact of their advertising on consumers and ensure it doesn't encourage inappropriate use of credit.

BNPL is often presented as the default payment method online

4.35 In some instances, BNPL offers are presented as a default payment method or in a long-list of indistinguishable options. The details of each option are not made clear upfront and this can be confusing for consumers and make it difficult for them to make an informed choice. In Sweden, the E-Commerce Payments Bill, which came into force in July 2020, prohibits credit options from being presented before debit options on online retail platforms. As a result, BNPL offers can't be presented as the 'first choice' ahead of the lowest cost direct payment option.

'There are too many options, it's confusing, I'd rather have only the ones I already use'
Nubia, BNPL user

Is there enough protection for vulnerable consumers?

4.36 Respondents to the Review specifically raised concerns about the risk of harm that BNPL poses to those with mental health problems. Money and Mental Health set out that in a 2016 survey of nearly 5,500 people, it found that people with mental health problems are more likely to take out point of sale credit than those who have not had a mental health problem. And in their recent publication 'Convenience at a Cost', they highlighted that a number of commons symptoms of mental health problems can make it harder to manage money and control spending, including low motivation, unreliable memory, limited concentration and reduced planning and problem-solving skills. BNPL providers and retailers need to be aware of the heightened risk around the use of their products by certain groups of consumers and ensure they factor this into the design and presentation.

' I felt a buzz, I could buy so much stuff! But I needed to be careful, my impulsiveness could be my downfall'
Kelly, BNPL user

Affordability

4.37 Most BNPL providers complete a very basic credit assessment, usually through a combination of soft credit searches and previous repayment history. This often focuses on credit risk, rather than affordability. Many providers rely on lending once and seeing if they are repaid as a means of managing their risks, rather than a wider attempt to consider affordability.

4.38 Most providers apply limits to the amount of credit they'll extend in the first instance and won't allow consumers to continue using their product if missed payments are outstanding. Although not a consequence of not being regulated, as providers are not required to report repayment history to Credit Reference Agencies (CRAs), consumers with outstanding payments can seek credit from alternative BNPL providers and equivalent regulated products without their credit history being available for scrutiny.

4.39 In addition, the review was told by a major UK bank that of 677,000 of their personal current account (PCA) customers who made a payment to two of the large BNPL providers in November 2020, 10% had exceeded their overdraft allowance in the same month (and therefore exceeded an existing PCA facility in the same period).

4.40 It is essential BNPL providers properly consider affordability for consumers, particularly as they may not have visibility of missed payments with other providers or consumers' wider financial circumstances.

Potential to create high-levels of indebtedness

4.41 In a market where retailers can offer consumers access to multiple BNPL offers from various providers, the use of affordability assessments and credit limits can have limited impact. A number of consumer research participants explained that if they are rejected or reached their limit with one provider, they look to use an alternative one.

'If I'm at my limit with Klarna, I'll look and see if the shop offers another type'
Lola, BNPL user

4.42 The average amount borrowed per transaction can be comparatively quite small (between £65 and £75). But consumers may have multiple outstanding transactions across different providers and so there is a risk the overall amount owed can be much greater. In theory, it would be relatively easy for a consumer to amass around £1000 of BNPL credit using multiple lenders. BNPL providers are looking to widen their scope from predominantly fashion and accessories, and are starting to partner with higher value retailers, including homewares and household electricals. This could increase average transaction values and therefore outstanding balances.

Late payment fees, defaults and collection practises

4.43 BNPL providers take a variety of approaches to late payments, defaults and collection practises. Some charge late payment fees, capping them at a percentage of the initial transaction, while others don't charge anything at all. Some (but not the majority) report late payments and defaults to CRAs. Some pass debts onto debt collection agencies while others write the debt off. Most providers won't continue lending to individuals who have outstanding payments with them.

4.44 Retailers present BNPL options in a variety of different ways at online checkouts. The details of each provider, including their approach to late payments and defaults, are often not clear. This evidence of key information hidden in terms and conditions pages, can harm a consumer's ability to compare payment options and make an informed decision on which payment method is right for them.

'I'm not sure if they do a hard credit check... only soft... not sure if that affects your credit score'
Katie, BNPL user

'I just remember it being so easy, I don't think I clicked to get more info'
Kelly, BNPL user

4.45 The arrears levels of some BNPL providers can be quite high and for those that charge late payment fees the revenue from such fees can make up a significant portion of the firms' overall revenue. There is therefore a risk that other providers could adopt this approach, whether they are existing firms changing their approach or new entrants.

Impact on wider credit market

4.46 Many of those responding to the Call for Input highlighted the fact that most providers do not report to CRAs. This lack of transparency means regulated credit providers may not have a complete view of a consumer's financial position when assessing affordability. This could lead to consumers being approved for credit which they can't afford.

Expansion of BNPL products

4.47 Some BNPL providers are looking to expand beyond online retail platforms, to allow consumers to use it in-store. In-store advertising will need to ensure consumers are aware of the consequences of use. BNPL providers and retail partners will also need to ensure in-store staff are not incentivised to encourage inappropriate use of BNPL products.

International approach to BNPL providers

Growth of BNPL in the UK is consistent with the global market. The review has looked at the treatment of BNPL offers in a number of foreign jurisdictions.

Sweden

In Sweden, the E-Commerce Payments Bill came into force in July 2020. It prohibits online retail platforms presenting credit options before debit options. As a result, BNPL offer can't be presented as the 'first choice' ahead of the lowest cost direct payment option.

Australia

In November 2020, the Australian Securities and Investments Commission (ASIC) published Rep 672 (following Rep 600 in November 2018).This report highlighted the evolution of the Australian retail credit market and the increase in demand for BNPL.

It reported that in June 2019 there were 6.1m open accounts, representing 30% of the Australian adult population. The number of transactions increased from 1.9m in June 2018 to 3.4m in June 2019, representing a 75% increase and the total value of all transactions increased in the same period by 79% to £$AUS5.6bn.

As this review has identified, when used responsibly BNPL can be a useful tool for consumers, but ASIC also identified the increasing number of consumers who miss payments. In 2018-19 missed payment fee revenue across all BNPL providers totalled $AUS43m, a growth of 38% compared to the previous financial year. ASIC also found some consumers were in financial hardship as a result of taking out BNPL arrangements, cutting back on essentials or taking out additional loans in order to make their repayments on time.

As a reaction to the growth in Australia, from October 2021, design and distribution obligations will apply to BNPL providers. They will need to monitor and review the outcomes of their arrangements and consider whether changes are required. An industry-led code of practice for BNPL providers is expected to be effective from March 2021. The Product Regulation Act will also give ASIC the power to address significant consumer harm from BNPL arrangements.

United States

Regulation of BNPL depends on the structure of the product and the entity offering it. Non-bank providers generally structure BNPL offers as 'retail instalment sales contracts' to avoid the application of certain federal and state laws governing consumer credit.

Nonetheless, non-bank BNPL offerings have attracted state regulatory scrutiny, raising the prospects of future legal challenge. In 2020, the state of California fined Afterpay, Sezzle and Quadpay for what the state deemed to be the collection of illegal fees.

Recommendation 18

There has been significant growth in unregulated BNPL products in recent years. The products and business models in the market, as well as those which may be developed in the future, can lead to harm. Regulatory oversight is appropriate to ensure that the product develops in a way which is beneficial to the end consumer. As a matter of urgency, the FCA should work with the Treasury to ensure the necessary amendments to legislation are made to bring BNPL products within the scope of regulation. Once the necessary powers are obtained the FCA will need to develop a proportionate regulatory framework including addressing how credit information should work within this market. In defining the regulatory framework for BNPL, the FCA and the Treasury should take care not to include other non-financial organisations that rely on the current exemption, including healthcare services and sport clubs.

Regulatory approach to partner retailers

4.48 As part of this recommendation consideration will also need to be given to the regulatory treatment of partner retailers. Once exempt BNPL agreements are brought within the perimeter, Article 36A(1)(a) of RAO will be met and the retailer will need to be authorised for credit broking. A number of the harms set out above relate to the presentation of the BNPL offers which in most cases will be on a retailer's website. It's therefore important retailers are subject to appropriate high-level regulation to ensure they treat consumers fairly.

4.49 Major larger retailers, who already offer regulated credit, and account for a bulk of retail transactions will already be authorised by the FCA. However, beyond these the main BNPL providers partner with many hundreds of retailers, which vary in scale and sophistication. It will therefore be important to ensure the regime applying to retailers is proportionate and options are available to them. Retailers could, for example, fall under Appointed Representatives Regime rather than having to seek direct authorisation. The BNPL providers would have responsibility as the Principal for ensuring compliance with the relevant rules. Becoming an Appointed Representative is currently optional and retailers could still seek to be directly authorised. We could also expect some retailers to not want the responsibility of being authorised and to withdraw from the market – this is likely to be a positive measure that improves consumer protection. This will need to be considered in the round in any future implementation consultation the FCA undertakes.

Employer Salary Advance Schemes

4.50 Compared to BNPL, the market for Employer Salary Advance Schemes (ESAS) is still in its relative infancy. There are a small number of providers who partner with employers, predominantly across the hospitality, retail and healthcare sectors. Nonetheless, we are seeing new providers joining the market and expect the sector to expand in the next few years.

4.51 ESAS allow employees to access some of the pay they have already earned before their regular payday. There is often a fee to use the service. These schemes are a recent development, and are usually administered by specialist operators. The schemes typically use software to connect with the employer's payroll operations and employee's bank account. Some scheme providers also provide the cash flow funding to the employer to facilitate the early payment of wages.

4.52 ESAS operate entirely outside of credit regulation as the early payment of accrued wages does not usually involve the provision of credit. Though employees often see these services as substitutes for loans, they do not have the regulatory or statutory rights and protections which apply to credit products. For example, neither ESAS providers or employers are required to conduct affordability assessments and employees are unable to refer complaints about ESAS to the FOS.

4.53 These products are only available to an individual if their employer has partnered with an ESAS provider. ESAS providers usually partner with large organisations. As these products become more established and benefits are identified more employers are expected to use them.

4.54 Some of the main providers allow employees to use an app to track the wages they've accrued during the month. The employer sets a limit on the percentage of accrued wages an employee can withdraw – normally no more than 50% and in some cases 25%. Most ESAS providers either charge a fixed fee per withdrawal (usually under £2) with any advances being deducted from the employee's salary for that pay cycle as part of the payroll process.

4.55 Data shared by ESAS providers indicates advances arranged via their apps are used for many different purposes, including groceries, bills, general expenses and travel. Although traditional employee advances might be for hundreds or even thousands of pounds, withdrawals made via ESAS can be for as little as £10.

4.56 In July 2020, the FCA published a statement on the potential risks of ESAS and how employers and scheme operators could reduce them.

Benefits of ESAS

4.57 As highlighted in the FCA's July 2020 statement, ESAS have benefits for users. Employees can use them to 'smooth' their income throughout the month to better manage regular monthly spending or deal with unexpected or emergency expenditure. Depending on how they are used, they can be a low-cost, easy-to-access alternative for people who may not be able to access mainstream credit. There is no need to actively repay anything at the end of the month as withdrawals are automatically deducted as part of the payroll process.

'You don't have to worry about making any payments – they just deduct it before they even pay you so it's nice and easy'
Adam, ESAS user

4.58 ESAS are part of a wider trend for employers to include products and services which increase financial wellbeing in their benefits packages. The app-based system many providers use often includes tools to help employees monitor their finances and some are introducing incentives to encourage employees to save and become more financially aware. Some providers focus on educating users to help them avoid getting into persistent debt and include signposting to debt advice charities.

4.59 Some providers integrate with an employer's payroll and overtime systems to allow those who take an advance to work extra shifts during the month, with the aim of ensuring their final monthly take-home pay is largely unaffected.

Potential harms of ESAS

Short-fall at the end of the month

4.60 Respondents to the Review highlighted concerns that using ESAS could result in short-fall at the end of the month. This could result in persistent use of the product, escalating charges or driving consumers to use mainstream or potentially high cost credit to 'bridge the gap'. It is important ESAS providers and employers monitor use and proactively engage with employees whose usage indicates they are in financial difficulty.

Regular use makes fixed fees expensive

4.61 Most ESAS providers charge a fixed fee for withdrawals and some cap their fees. For those that don't, although modest as a one-off charge, usage can result in the fees amounting to a higher rate of interest than some high-cost credit products. Data shared with the review indicates ESAS are primarily used between 1-3 times per month with usage usually spread out across the month. Although frequency of withdrawals is generally low, respondents shared their concern about the transparency of fee pricing. They were concerned that consumers wouldn't be able to compare ESAS with credit products available to them, which could result in them missing out on access to cheaper credit elsewhere.

Supporting individuals in financial difficulty

'I would like to keep it personal and my employer not to know. It could affect your progression'
Paul, ESAS user

'I wouldn't really want my employers to know that I'm struggling with money every month'
Emily, non-ESAS user

4.62 Consumer research indicated prospective consumers can be worried about the potential implications of their employer's knowing they had made a withdrawal. One provider told the review they anonymise any data shared with partner employers.

4.63 Given there are 2 parties involved in providing an ESAS, it's important to consider who is responsible for identifying, and supporting, individuals in financial difficulty. This is particularly important if usage data may be anonymised by the provider, thus affecting an employer's ability to intervene on an individual basis.

4.64 Providers often integrate push notifications into their platforms to highlight repeat usage as well as signposting to debt advice charities. A partner employer has explained how they tailored internal communications, based on data from the provider, to discourage potentially negative use of the scheme. Despite these examples, the review hasn't seen examples of interventions involving specific individuals.

4.65 As such, it's essential consumers in financial difficulty do not fall through the gap between the ESAS provider and employer. There must be greater clarity over who has ultimate responsibility for monitoring and supporting individual employees who may be in financial difficulty. It's essential both the ESAS provider and employer understand who is responsible to minimise the risk of harm to consumers.

ESAS providers who also offer regulated credit

4.66 Where ESAS providers also offer regulated credit products, or at least act as a broker, there is a potential conflict of interest. If poor use of an ESAS creates a need for credit, for example, to cover a shortfall in wages at the end of the month, the provider could profit from this if they offer alternative credit products.

4.67 As such, it's important ESAS providers treat consumers who may be in financial difficulty fairly and consider that it may not be appropriate in certain circumstances to market alternative credit products which could cause further harm. Providers should ensure the design of their digital platforms encourages responsible use of ESAS and doesn't deliberately drive employees to use credit products offered by the ESAS provider.

Interplay with credit providers

4.68 ESAS providers do not report usage to CRAs. This lack of visibility means credit providers are not able to take account of usage as part of their affordability assessment. While using an ESAS doesn't change the amount an employee is paid during the month, it may still be relevant to a lender's assessment to ensure any credit they offer is affordable. For example, being able to take into account that an employee may already have withdrawn some of their salary before payday or where the pattern of ESAS usage indicates an individual may be in financial difficulty. Nonetheless, this issue is less acute when compared to the lack of visibility of BNPL offers.

Potential connection with other commercial services

4.69 Some operators in this market are willing to offer the ESAS service at no charge to the employee or the employer, as long as the employer also takes certain other commercial services with the operator, for example, factoring invoices. Care should therefore be taken to ensure employers do not become locked-in to a service that could offer worse value in the future.

Recommendation 19

Employer Salary Advance Schemes (ESAS) offer a low-cost alternative to using credit like payday loans or overdrafts. If used appropriately they can give employees benefits and greater control of their finances. While wider regulation may not be immediately necessary, the FCA should take a proportionate approach and continue to closely monitor market developments and guard against risks to individuals. These risks can include inappropriate relationships between employers and lenders. For example, lenders 'locking in' employers through linked commercial contracts, or cross-selling of inappropriate financial services products to employees. The FCA working with the government should encourage ESAS providers and major employers to draw up a code of best practice. Where firms are regulated for part of their activity by the FCA, the FCA should look to formally recognise the code. Further, major employers should be encouraged to only contract with ESAS providers adhering to this code.

4.70 Given the size and scale of the market, it would be disproportionate, at this time, to introduce a bespoke regulatory regime. Unlike BNPL, ESAS is not a form of credit relying on a legal exemption, and would therefore require significant regulatory change to be brought within the perimeter. Although the Review has identified a number of risks of harm associated with use of these products, the Review hasn't seen evidence of crystallisation or widespread consumer detriment. Nonetheless, the market should continue to be monitored and if the position changes, the question of bringing ESAS within the FCA's remit should be re-considered.

5 The role of regulation

5.1 Regulation has a vital role to play in delivering a healthy credit market. This involves acting where poor and harmful practices are identified and to help rebalance incentives where there are conflicts of interest. But the regulator also has a role in setting out what outcomes a well-functioning credit market should be achieving and driving the market in that direction. When it works well, regulation not only prevents harm but maximises the benefits of the market to consumers and firms. However, the current legal and regulatory approach to credit needs attention if it is to fulfil this role.

Regulation must be clear on what outcomes it is looking to achieve, and to ensure these are met across all products

5.2 While the majority of the FCA's consumer credit rules apply to all regulated agreements, many recent rules have focused on specific products. This has been for good reasons, including reacting to fast growth in specific markets such as with high cost short term credit (HCSTC) or following the evidence from sector specific studies such as the Credit Card Market Study. When inviting input ahead of the High-Cost Credit Review in 2017, respondents overwhelmingly supported the FCA taking a product-focused approach rather than looking at high-cost credit as a whole, due to the significant differences between the products. In many cases, technical differences between products will drive a need for rules to differentiate between them.

5.3 Despite this, it is important that regulation does not lead to different outcomes for consumers of different products, especially where similar harms exist. In part, a level of consistency is needed to ensure that regulation doesn't distort the market, with differences in regulatory approaches giving advantages to one form of credit over another. This can drive substitution effects where regulation merely changes what type of credit people use rather than the outcomes they achieve. Moreover, the legal differences between different credit products does not necessarily mean that consumers use them differently.

5.4 The FCA's Consumer Credit Business priority in its 2020 Business Plan provides an opportunity to look at how regulation can be more consistent across different products by setting out clearly the outcomes the FCA expects to see in the market. This would allow a more holistic approach to be taken to regulation that looks at the substitutability of credit products and treats them based on the outcome.

5.5 For example, having clear outcomes around repeat or persistent lending (regardless of what product is being used) would enable the FCA to evaluate the effectiveness of specific interventions for credit cards or overdrafts in a consistent way and to ensure that consumers are receiving similar protections for both these products. It would also provide a structured approach to looking at other products and whether further interventions are required to deliver these outcomes consistently across the credit market.

5.6 Similarly, for the FCA to answer questions around whether the current approach to information disclosures is effective or if additional frictions are needed in digital settings (discussed in Chapter 4), a necessary first step is to have a clear statement of what outcomes are needed at this point in the consumer journey. With that in hand, lenders can be clear about what they need to have in mind when developing their products and business models, and the FCA can be clear about how its activities support these outcomes.

5.7 An outcomes-based approach to regulation does not mean that all rules should necessarily be outcome-based, leaving firms discretion into how the outcome is achieved. In some cases, a prescriptive remedy setting out exactly what actions a firm must take may be the best route to achieving an outcome, while the opposite may be true in other areas. Nor does it mean that the FCA should aim to have the same set of rules for all products, as differences between products may require different interventions. Regulation needs to be clearer about the overall direction it is taking in language more detailed and specific to the credit market than 'reducing harm' or 'responsible lending'. Outcomes based regulation also needs to work with how consumers use different credit products and look at comparable regulations between substitutes rather than purely focus on the stated legal form.

5.8 Some respondents suggested the Review consider the benefit of a pause on new regulation for a few years to allow industry to take stock of previous changes, although more wanted the regulator to act swiftly when there is evidence of harm. Stepping back, what unites these views is a need for clarity on what a healthy credit market looks like so that regulation can be seen to be heading in a clear direction. One respondent wanted the Review to help 'the FCA to set out its vision of what a successful and responsible unsecured credit market in the UK looks like'. This is exactly what an outcome based approach should seek to achieve. By setting out clear outcomes which remain consistent over time, lenders and borrowers will have clarity about the overall direction of travel for regulation. The benefit of this would be a clearer view of the purpose of regulation, greater consistency of outcomes across different products and a vision of what a healthy market looks like which can sit at the heart of firms' cultures across the industry.

Recommendation 20

Since taking over responsibility for the regulation of consumer credit, the FCA has had the opportunity to study specific parts of the market and product types and respond to the harms which it has identified. This has been necessarily undertaken by sub-sector but as the FCA takes forward its Business Plan Consumer Credit Priority there is an opportunity for the regulator to set out clear outcomes which a healthy credit market should be achieving across all products and sectors. The FCA should use its Business Plan Priority to take an outcome based approach to regulating the credit market and set out clearly what the market should be achieving at each stage of the consumer journey and lifecycle of a product and how regulation can support that. This should include outcomes regarding: financial promotions, information disclosures, affordability assessments, persistent debt/repeat lending, forbearance, debt advice and solutions and debt collection. Outcomes should also be developed around the recovery of consumers who have had financial difficulties and their ability to access credit over time. Regulatory initiatives should be identified and evaluated with reference to these outcomes. This should include ensuring equivalent approaches and protections where consumers use particular products as substitutes or where similar harms are present. The FCA should make these outcomes public to ensure firms have clarity around the direction of future regulatory initiatives.

5.9 Later in this chapter we set out two areas where clearer outcomes are needed: forbearance and persistent debt. However, the need for clear outcomes which the market, and regulation, should be aiming to deliver is a key theme across this report and its recommendations.

Affordability assessments will always be of critical importance, but regulation needs to be effective across the whole consumer journey and not only the beginning

5.10 Since taking over regulation of consumer credit in 2014, the FCA has focused significantly on affordability. This makes sense: high standards around affordability and creditworthiness assessments are central to a healthy credit market.

5.11 While important as a tool to prevent consumers taking on debt where it is likely to lead to problems, poor affordability checks are not the only cause of problem debt. Changes in circumstance, including health problems, unemployment or relationship breakdowns can all lead to financial difficulties and make previously affordable credit unaffordable. Placing clear responsibility on firms to identify and reduce harm throughout the consumer journey creates incentives from firms to conduct good quality affordability assessments and reduces consumer harm where these are not sufficient. It is therefore critical that regulation places sufficient emphasis on the whole relationship between lenders and borrowers and not only at the start.

Detailed prescription around affordability assessments is not appropriate, but regulatory uncertainty should be minimised where possible

5.12 While no respondents to the Review challenged the importance of affordability assessments, several raised concerns around the principles or outcome-based nature of these rules. They felt that they led to inconsistency between firms and uncertainty around compliance. Some respondents called for the FCA to make the affordability rules more prescriptive. They said this would give greater clarity and reduce uncertainty around compliance, and thus stimulate more growth and activity in the credit market.

5.13 While prescription, perhaps in the form of a minimum set of checks, would bring greater clarity for firms around compliance, it is not clear that it would drive better outcomes. Given the wide range of credit products and need to consider the individual circumstances of consumers applying for credit, increasing the level of prescription may lead to a burdensome and restrictive set of rules with little benefit. Changes in the types of credit information available and new analytic tools could mean prescriptive rules become unnecessarily rigid, requiring frequent updates or putting up barriers to innovation or access to credit. Ultimately, a firm's ability to make a judgement on whether a consumer is creditworthy or credit is affordable is a core competency of operating in a credit market. It is not unreasonable to expect firms to be able to operate under an outcomes-based framework for these assessments.

5.14 Respondents raised concerns that future action by the Financial Ombudsman Service (FOS) around affordability was acting as a barrier to firms lending or entering the market. The FCA and the FOS both have an important role to provide protection for consumers and it is critical that the two organisations act in an aligned and coherent manner. We note that in November 2020 the FCA and the FOS held a joint public meeting attended by high-cost lenders with the aim of providing greater clarity to firms, as well as 'myth-busting', around how complaints are handled. These actions are important to reduce uncertainty and should continue.

Recommendation 21

The FCA and the FOS already coordinate in order to ensure their activities align and drive shared outcomes. However, this is not always the perception of lenders and their funders which can have a potential cooling effect on investment and growth. The FCA and the FOS should take forward a coordinated campaign of external activity to reduce perceptions of regulatory uncertainty in the credit market, particularly for affordability.

Repeat lending and forbearance both need clearer outcomes and greater consistency from the regulator

5.15 At present the FCA has rules to tackle persistent debt in credit cards and repeat use for overdrafts. In both, while consumers may be able to afford the interest and any minimum payments without sufficiently severe financial difficulties to trigger forbearance rules, they may still be stuck with debt which is expensive to service and no clear route to paying it down.

5.16 Consumers in this position are usually profitable for lenders, which reduces incentives on firms to identify harm and take action. The rules, in each case, seek to address this by requiring firms to actively monitor or identify consumers who may benefit from help. The rules require firms to prompt consumers to act where they can and then, in certain cases, requires them to take steps to help the consumer move out of longer-term debt. The rules for credit cards are more prescriptive than for overdrafts, for example setting out specific definitions of which consumers are in 'persistent debt'.

5.17 Several respondents to the Review highlighted that there are significant numbers of consumers repeatedly taking out fixed term, often high-cost, loans in a manner comparable to using a revolving product. In August 2020, the FCA published the findings of a Supervisory investigation into relending in the high-cost sector which found similar issues as those in the overdraft and credit card markets. Repeat borrowing can often lead to increasing levels of debt and repayments over time which, while strictly affordable, may be very expensive as a form of longer term borrowing. As with overdrafts and credit cards, these consumers may not be in arrears or in circumstances triggering forbearance, but may still be stuck in cycles of debt without any clear route to getting back to a more sustainable position.

5.18 This is not a case of consumers using credit products in the 'wrong way'. There are good reasons why consumers need to take out repeated loans. It is also not necessarily irresponsible of firms to build business models which involve repeat lending, although repeat borrowing can be an indicator that the borrowing is not sustainable. Where consumers may have poor credit scores or firms have limited information there is a place for carefully (and affordably) extending small loans to build a fuller picture of the consumer's creditworthiness to responsibly extend them more meaningful sums over time.

5.19 There are clear risks relating to repeat lending. Some of these relate to affordability as repeat use of credit can be a sign that the consumer is struggling with their debts. The courts have confirmed, in the recent *Kerrigan* case, that a history of HCSTC borrowing and its potential effects on a consumer is relevant to the creditworthiness assessment a firm is required to carry out under current FCA rules. This is likely to include considering whether there was a pattern of borrowing which indicated a cycle of debt; whether money would be borrowed from one source to repay another; or whether the timing of loans, for example paying off one loan very shortly before the application for another, indicated a reliance or increasing reliance on HCSTC. Firms therefore have a responsibility to take the pattern of repeat lending into account when looking at the affordability of a subsequent loan. The courts have also confirmed that a breach of FCA rules by failing to consider these factors is likely to be a powerful factor in considering whether there is an unfair relationship between the lender and the customer for the purposes of s.140B of the Consumer Credit Act 1974, which could entitle the customer to redress.

5.20 But, as highlighted above, affordability is only part of the picture and regulation needs to consider what protections are needed even where loans are affordable. This includes the points on persistent debt discussed above and tackling incentives on firms to pressure consumers into taking out multiple or larger loans. Regulation has a key role in ensuring firms manage all these risks well, while not driving sub and near-prime borrowers out of the market.

Recommendation 22

Building on findings from the Credit Card Market Study and High-Cost Credit Review, the FCA introduced rules for repeat or persistent use of credit cards and overdrafts. Repeat use of fixed-term loans and 'low and grow' business models has led to loans being used in a similar way to revolving credit and with similar risks. There is a place for such lending in the market, but consumers need the same level of protection as for revolving credit. The FCA should conduct a review of relending. This should set out clear outcomes covering repeat lending and persistent debt across all products. It should look at whether additional protections or guidance are needed around relending of fixed-term loans to achieve these outcomes in light of the findings of the FCA's recent work on relending in high-cost credit.

5.21 The pandemic gave a clear example of the importance of effective forbearance, especially where consumers are affected by circumstances beyond their control. As discussed in Chapter 2, there was general support for the FCA's clear and specific approach to forbearance during the pandemic. While a narrow focus on payment deferrals would not be appropriate in general, many respondents saw merit in making the current forbearance rules more prescriptive than they currently are.

5.22 At present, there is a perception that consumers receive inconsistent outcomes from different lenders when seeking forbearance. One respondent from a debt advice charity spoke of 'cultural differences' between lenders when looking at how they approach forbearance. This is not an area where firms should be in doubt about their responsibilities and where consumers should expect the same outcomes regardless of what particular product they have or which lender they are with.

5.23 There is a case for greater prescription in the forbearance rules to ensure more consistency between lenders. This may include clearly setting out what types of forbearance all firms should actively consider. This would act as a minimum standard for firms to include as part of their forbearance processes, which would drive greater consistency. Furthermore, clarity around what types of forbearance consumers could request may encourage them to engage earlier with creditors, which would benefit both consumers and firms. As set out above, the FCA should be clear about what outcome forbearance needs to achieve and then craft regulation to achieve this.

5.24 There is also a case for refining the trigger for when firms are obliged to offer consumers due consideration and forbearance. At present, for many credit products this obligation applies to firms when consumers are in default or arrears difficulties. Where a consumer has a change in circumstances and it is clear that they are likely to enter arrears or have difficulties meeting their obligations, they should be encouraged to pro-actively approach their lender for support. It does not seem appropriate for firms to wait until the consumer is in actual distress or arrears before they are obliged to consider what help they can offer.

Recommendation 23

In 2020, the FCA acted decisively during the early stages of the pandemic by introducing greater prescription into how firms treat customers in financial difficulties or who requested forbearance, even if they were not in arrears. Building on the temporary guidance in 2020, the FCA should conduct policy work to review its overall approach to forbearance. This should look to set out clear outcomes for the forbearance process and firms' responsibilities in achieving these. The FCA should consider a more structured and prescriptive approach to achieve a level of consistency between firms' approach to forbearance. This is likely to benefit both consumers and firms.

The regulatory framework must allow for regulation to easily adapt to change and promote innovation

5.25 The consumer credit market is subject to several layers of primary and secondary legislation, including the Consumer Credit Act (CCA) and the FCA Handbook. The CCA was originally passed in 1974 and reviewed and updated in 2006 to take account of changes in the market over the previous 3 decades. The CCA was updated once again to align the CCA with the 2008 Consumer Credit Directive and some further changes were made when the FCA took over regulation of the consumer credit market in 2014.

5.26 Despite these changes, several respondents to the Review felt that the CCA still did not reflect the current and changing state of the market. Several respondents highlighted that the CCA was not well suited to finance involving emerging technologies such as electric cars. Measures in the CCA for consumers in arrears were seen to be overly burdensome on firms and unnecessarily alarming for consumers. Further, the CCA was viewed as a barrier to innovation and there was a view that sanctions for non-compliance could be disproportionate and required more nuance.

5.27 In March 2019, the FCA published a review of the CCA provisions ('the CCA Review') which had not been transferred into the FCA in 2014. The CCA Review considered the benefits of these provisions, their proportionality and where there could be value in transferring some provisions over to the FCA Handbook. Importantly, the CCA Review looked to 'identify areas where there may be scope to simplify or modernise aspects of the regime or remove unnecessary or disproportionate burdens, reflecting our broader approach of principles-based, outcomes focused regulation.' Respondents to this Review who raised concerns with the CCA tended to point to the CCA Review as a valuable analysis which the FCA and government needed to build on.

5.28 As discussed in Chapter 4, the growth of digital lending and online retail, together with new insights from behavioural science, raise questions around whether firms could present information to consumers in more effective ways. The CCA Review noted that transferring provisions around information requirements would offer a clear opportunity to review how information is presented in the most effective way to consumers. Continuing with the work on CCA reform set out by the CCA Review, in the context of wider regulatory reform following the on-shoring of the Consumer Credit Directive, will provide a critical opportunity to improve outcomes in the market and create a healthy unsecured credit market.

Recommendation 24

To achieve a regulatory system which is more outcomes focused across the whole consumer journey, changes will be needed to both the CCA and the FCA Handbook. Much of the groundwork for CCA reform has already been laid by the FCA's 2019 report. The FCA must engage with the Treasury to prioritise the work on CCA reform.

Recommendation 25

The UK's exit from the European Union also creates additional flexibility in credit regulation which needs to be considered as part of the CCA reform work. This includes greater flexibility on information disclosures such as Annual Percentage Rate (APR) and the inclusion examples of cost of credit in pounds and pence. The FCA should conduct a review to identify what additional flexibility will be available to the FCA and the Treasury following the UK's exit from the European Union and how this can deliver regulatory outcomes in the unsecured credit market, including around information disclosures in simple terms like pounds and pence costs.

6 Conclusion

6.1 This report attempts to cover a vast subject and a wide range of recommendations in as succinct a way as possible.

6.2 Very different visions are available for the UK credit market, which would be perfectly credible based on other European models, but all would come with pros and cons and trade-offs that are properly decided by a democratically elected Parliament.

6.3 What this report has sought to do is take stock of a very wide market, where there are the biggest innovations, the changes brought about by Covid-19 and how the existing UK system could be healthier and more sustainable in the long term.

6.4 Inevitably, in a report of this kind there will be many topics that can only be touched on in the briefest terms and will need to be explored in detail in the future. Nevertheless, there is clearly much to do.

6.5 Some of the recommendations here, especially around Buy Now Pay Later (BNPL), the response to Covid-19 and debt advice clearly are both urgent and timely. However, being realistic the FCA will need to have a programme of delivery to achieve the full agenda set out here. Consumer credit is a Business Plan Priority for the organisation, but there are both other business plan priorities and the ongoing effect of the pandemic to manage. In line with the suggestions in this report the FCA will need to establish clear outcomes and metrics to measure progress for its work.

6.6 However, what should be clear from this Review is that an improved unsecured credit market is possible in which regulation responds rapidly to new potential harms, consumers have more consistent protections, the credit information market can serve everyone better, sustainable provision is encouraged, there are more choices of mid and low-cost credit, and when things do go wrong the system works consistently to help people recover.

Recommendation 26

While certain work is clearly very urgent, particularly BNPL, the response to Covid-19 and debt advice, delivery of the overall package recommended by this Review will take time, especially with resources under pressure linked to the ongoing Covid-19 situation. A programme of reform needs to be set in place. Therefore, the FCA should appoint an accountable executive to carry forward the recommendations accepted by the Board. There should be a clear, public timetable for change and the Board should report a year from now, and annually thereafter if necessary, on progress.

Annex 1
Terms of Reference

The terms of reference for the Review are:

- To examine the current state of the unsecured credit market in the UK including the component parts, recent changes in size and scale, whether in regulated or in adjacent unregulated products.
- To examine changes in regulation, noting those areas that have been subject to regulatory oversight in recent years from a variety of bodies including the FCA (for example overdrafts or high cost credit), and comparing likely harms or dynamic effects seen in those areas.
- To examine the immediate effect of coronavirus on demand for unsecured credit and on the role of credit information.
- To report on possible trends and potential future pressures.
- To identify areas of growth in demand from consumers for credit including from non-traditional providers of credit.
- To present an assessment of the benefits and harms evident in the market and those that may be expected as the market develops.
- To compare international approaches to these issues where relevant.
- To make conclusions and recommendations to the FCA Board on management of harms in this sector; gaps in understanding or data; potential changes in regulation for the FCA to consider; advice on potential changes to the overall system the FCA may wish to consider with other authorities or the Government; and possible innovations to support a sustainable market.

Annex 2
Membership of the Advisory Panel

Member	Profile
Phil Andrew	CEO, StepChange
Steven Cooper	CEO, C Hoare and Co Chair, Experian Limited Interim Chair, Social Mobility Commission
Natasha de Teran	FCA Consumer Panel Non-Resident Scholar, Carnegie Endowment for International Peace (FinCyber Programme)
Kirsty Good	Head of Campaigns, PR and Social, MoneySavingExpert.com
Malcolm Le May	CEO, Provident Financial Group Plc
Vim Maru	FCA Practitioner Panel CEO Retail Bank, Lloyds Banking Group
Rebecca Pearson	Operations Director, Bupa Care Services
Marlene Shiels	FCA Smaller Business Practitioner Panel CEO, Capital Credit Union
Caroline Siarkiewicz	CEO, The Money and Pensions Service
Helen Undy	Chief Executive, The Money and Mental Health Policy Institute
Kirsty Ward	Director, M&S Bank and Services
Therese Chambers	FCA Director, Retail and Regulatory Investigations Leading FCA's consumer credit priority

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