

# StepChange Debt Charity response to the FCA Review into change and innovation in the unsecured credit market (the Woolard Review)

**December 2020**

## Introduction

StepChange Debt Charity is the largest specialist debt advice charity operating across the UK. In 2019, over 630,000 people contacted us for advice and information on problem debt. We welcome this call for input to the FCA Review into change and innovation in the unsecured credit market (the Woolard Review).

## Summary

The long history of consumer credit regulation in the UK highlights how ineffective regulation can incentivise and even embolden firms to engage in (sometimes egregious) bad practice. In the absence of effective regulatory policy, some firms will be incentivised to profit through exploiting consumer vulnerability, behavioural bias and constrained options.

In the years since the FCA was given responsibility for consumer credit, we have seen a number of welcome interventions to address long standing areas of consumer detriment, including in the areas of payday lending, unauthorised overdraft charges and persistent credit card debt. Each problem had roots in incentives that misaligned the interests of firms and (at least some of) their customers. Each intervention aimed to mitigate or realign those incentives to some extent. The FCA, consumer advocates and firms should now know a good deal about the relationship between regulation and incentives from the perspective of effective consumer protection.

The FCA faces a number of existing and emerging challenges in the unsecured credit market:

- Coronavirus has exposed pre-existing problems of low household financial resilience, insecure incomes and safety nets that are not always adequate, and highlighted the weakness of the forbearance framework to deal with temporary financial difficulties.
- Digitisation of credit products has created new risks of poor outcomes for consumers, particularly those with vulnerable characteristics such as mental health problems.
- Systemic weaknesses in credit information and credit information governance work against consumer interests and undermine effective regulation.
- New products that sit outside the regulated space are likely to impact use of regulated credit products and consumer protection objectives.
- There are unaddressed weaknesses in the regulation of unsecured credit that contribute to the scale of financial difficulty and problem debt in the UK, particularly for high cost revolving credit products.

We would like one of the functions of this review to be to look at how well FCA remedies are working to change incentives and eliminate consumer detriment, and to consider how transparency on progress towards clearly stated policy objectives might hasten and embed change in the way firms think about incentives that may drive consumer detriment. We would also like this review to consider how to actively incentivise the development of unsecured credit products and services that align with the interests of consumers who are vulnerable to debt and other harms.

We have also highlighted priorities for the FCA in its response to this review and in its future programme, including:

- Developing an effective duty of care, building on vulnerability guidance, which should ultimately be embedded in regulation and require firms to pursue a ‘fair by design’ principle and not seek to profit from exploiting consumer vulnerability, behavioural bias or constrained choice.
- Considering how credit information governance can be reformed to work in the best interest of consumers, how forbearance and CRA reporting guidance can minimise financial exclusion for people facing temporary difficulties, and how to put in place a regulatory governance framework capable of ensuring new data technologies such as open data work in the interest of consumers.
- Undertaking a formal exercise to scope and evidence the need to bring unregulated products such as point of sale BNPL within FCA scope.
- Working with the government to end misleading promotions and information practices among lead generators in the debt solutions market.
- Consider whether the credit card persistent debt and overdraft repeat use rules need strengthening to prevent a new cohort of people falling into persistent debt, focusing particularly on high risk products that have the potential for greater detriment for customers through expensive persistent debt.

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

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

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

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

StepChange’s experience as a debt advice provider offers insight into patterns in unsecured credit use among those who experience severe financial difficulty and access debt advice. Our advice clients are diverse and span a range of demographic characteristics, but we see significant over-representation of certain groups such as those with low- to middle- incomes, renters, and specific household types such as single parents and younger adults.<sup>1</sup>

The unsecured credit products held by StepChange clients span mainstream and high cost products. Certain mainstream products are particularly common, including credit cards (68% clients in 2019), personal loans (48%) and overdrafts (46%). While any individual form of high cost credit is held by a

---

<sup>1</sup> StepChange Debt Charity (2020) [Statistics Yearbook 2019](#)

minority of those in financial difficulty, some forms are more common: in 2019, 36% of StepChange clients held at least one catalogue credit debt and 16% at least one high cost short-term credit debt. Holding at least one form of high cost credit is common for those in financial difficulty: in recent public polling, we found that 20% of those showing at least one indicator of financial difficulty, such as falling behind on bills, have used at least one form of credit included in the FCA's recent high cost credit review since March this year.<sup>2</sup>

The products held by clients reflect financial managing strategies and coping patterns as financial difficulty emerges. It is common for debt advice clients to hold multiple credit cards and other revolving credit products, reflecting a dependence on credit to meet spending needs, and one or more consolidation loans. These packages suggest that credit is used by those in difficulty both to meet spending needs and manage existing debt.

Certain groups of clients such as parents are more likely to hold clusters of high cost credit products including catalogue credit, retail store cards, home credit and short-term high cost credit. The reasons for using these products are similar—meeting spending needs and coping with repayment difficulty—but need is likely to be more closely linked to priority expenditure (suggested by higher levels of arrears on bills along these clients).

At a high level, StepChange's client group can be said to reflect long-standing event-driven drivers of demand for credit such as unemployment and ill-health, borrowing linked to persistent low income and stagnating living standards, and the risks of over-indebtedness inherent to a market that provides ready access to credit to most with only partially effective safeguards and protections.

The digitisation of credit products is increasing the accessibility of credit and changing the way that credit is marketed and provided in ways that pose additional risks to consumers. Credit is more accessible and tends to be accessed on a relatively friction-free basis. Firm access to a range of personal and credit data allows more effective targeting of consumers, including those struggling with financial difficulty, which raises questions of firms' responsibilities and tensions between marketing and lending activity and principles embedded in regulation such as early intervention.

The transition to digital lending platforms and automated decision-making means that credit information has itself become a driver of demand for credit: consumers are increasingly aware of the significance of their credit report and this may lead them to use credit products as a means of influencing this information, either explicitly through 'credit builder' products or through a pattern of product use designed to improve a credit score.

StepChange has raised concerns that unsuitable forms of credit are marketed aggressively and on a sophisticated basis to people at risk of financial difficulty. We see this most explicitly in such 'credit builder' products that appeal to people struggling with high interest charges on existing debt who

---

<sup>2</sup> Large national poll conducted by YouGov Plc. Total sample size was 3,297 adults. Fieldwork was undertaken between 7th and 9th September 2020. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+). Further details and methodology can be found in StepChange Debt Charity (2020) [Tackling the coronavirus personal debt crisis](#).

hope to reduce costs by transferring debt to lower cost products. For many debt advice clients, credit builder products are part of late stage difficulty before coping strategies are exhausted. This trend is likely to strengthen as digital platforms are more closely integrated with credit information.

We have seen positive developments in regulation of unsecured credit lending processes such as stronger affordability and creditworthiness standards. However, we remain unconvinced that a systemic shift is underway: trends in over-indebtedness do not indicate this (for example, MAPS analysis has consistently shown a rising need for debt advice among people in financial difficulty) and the increased accessibility of credit through digitisation and limitations in credit data may undermine the effectiveness of these changes.<sup>3</sup> The impact of coronavirus is likely to have disrupted patterns of financial difficulty in ways that are not yet fully clear. Nevertheless, regulation had not, as of early 2020, reversed a long-term trend in rising difficulty and demand for debt advice.

To achieve a credit market that more effectively balances market and consumer protection objectives, the FCA should prioritise an effective duty of care set in the highest level of FCA rules that prevents firms profiting from consumer vulnerability, biases or constrained choices. This would more effectively embed principle 6 in firm culture, and would require revision of practices, products and business models that have an unacceptably high likelihood of causing or compounding financial difficulty.

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

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

**Q9: Please provide evidence and/or views on:**

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

Rather than outright exclusion from credit, we see the primary access challenge in the present market as one in which some groups are unable to, or do not, access *suitable* forms of credit. The majority of people will, at some (and often multiple) points in their lives, need the ability to spread the cost of a large payment or unexpected expenditure. However, currently, too many people have to rely on high-cost credit, or other forms of credit not best-suited to their needs, to do so, using it to purchase essential items, such as fridges, washing machines, cookers, school uniforms or to cover

---

<sup>3</sup> Money Advice Service (2018) [Mapping the unmet demand for debt advice in the UK](#)

other unexpected costs, such as repairing a car or a boiler. These people are more likely to be excluded from more mainstream, cheaper forms of credit, or to use products such as overdrafts or credit cards, which can be affordable, in ways that lead to high costs.

FCA-commissioned research has cast light on credit use driven by survival and emergency borrowing.<sup>4</sup> This research suggests the primary driver of such credit use is need, but that other factors such as low awareness of alternatives are a factor. The FCA found that around one in twenty (6%) UK adults, or 3.1 million people, have a high-cost loan now or have had one recently.<sup>5</sup> Certain groups have a higher than average use of high-cost loan products, including:

- younger people aged between 25 and 44;
- people with financially dependent children, and particularly younger single parents;
- renters in the private and social housing sectors;
- those with a physical or mental health condition or illness that affects their day-to-day activities; and
- people with no savings or investments.

Building on this work, StepChange has published analysis estimating that of eight million people who borrow to make ends meet each year, one million are using forms of high cost credit.<sup>6</sup> This analysis in turn supported a segmentation of demand for alternatives to high cost credit, including scaling up existing alternatives, developing a no-interest loan scheme at scale and extending social security grant provision for those for whom no form of credit is appropriate. This work has particularly informed StepChange's engagement with the government's Financial Inclusion Policy Forum and developments including the founding of Fair4All Finance.

Increasing focus has been placed on the need to offer alternatives to high-cost credit for these people. This has included specific efforts to improve the reach of credit unions and community development finance institutions (CDFIs). However, we know from our work with people vulnerable to, or in problem debt, that these sources are not always accessible to people.

StepChange has worked through the Financial Inclusion Policy Forum to support the development of a UK no-interest loan scheme as a solution for people who have a need for credit (or to spread the cost of goods), but for whom affordable credit alternatives, even with significant scaling up, would not be accessible or appropriate. This can be the case where people cannot safely borrow within the risk appetite of the lender, or within the responsible lending rules (i.e. they may be considered too high risk, or may not be able to afford the cost of the loan).

It is not clear to what extent there is a significant cohort of people excluded *entirely* from the credit market. We would welcome more research into credit exclusion, particularly in regard to those who turn to loan sharks as an alternative. This noted, we agree that in a responsible credit market there will be people unable to access credit because offering access carries excessive risks, such as harms

---

<sup>4</sup> Optimisa commissioned by the FCA (2014) *Consumer Credit Research: Low income Consumers*

<sup>5</sup> FCA (2017) *Understanding the financial lives of UK adults*

<sup>6</sup> StepChange Debt Charity (2017) [The high cost of credit A discussion paper on affordable credit alternatives](#)

associated with high costs; we would like the policy debate about financial inclusion to include more focus on ensuring people for whom credit is not appropriate do not access unsuitable credit by reducing demand and providing social policy alternatives such as grants. Limiting the debate to market considerations excludes important social policy considerations and options.

Barriers to addressing unmet demand for appropriate forms of credit include:

- Credit information: limitations of data can lead lenders to both include and exclude customers inappropriately, and inconsistency between credit reporting agencies means that firms may need to access more than one provider or gather more data themselves, increasing costs. A simplified, timely, consistent and comprehensive credit information framework would support more firms and not-for-profit providers to meet demand for credit appropriately.
- Consumer awareness: those most at risk of exclusion from appropriate credit are more likely to have low awareness of mainstream credit products and be subject to behavioural bias due to financial pressures or other circumstances. Patterns of credit use remain to some degree supply-led in the sense that marketing plays a significant role in driving consumer choice.
- The cost of lending: for high risk consumers there is a tension between affordability for customers and sustainability for firms. Ultimately, if all information and administrative barriers to responsible lending were removed, firms would still be faced with this trade-off since risk is inherent to lending. We have noted that we see a role for social policy in meeting need that cannot be responsibly met within a market. With this in mind, policy makers could give consideration to ongoing subsidy for affordable credit providers that meet an identified social need. We also note other options are available to policy makers such as placing financial inclusion duties on firms offering mainstream products, which would support inclusion at the cost of an increase in price. Disclosure duties that require firms to report on who they lend to could also promote financial inclusion and support policy making.

We are cautious about some regulation-focused proposals to support the growth of smaller affordable credit providers, such as increasing the flexibility of affordability and creditworthiness assessments for small value loans. Our experience is that small value loans can still cause harm to consumers: for example, because they are taken out alongside other loans and form part of a cumulative pattern. Lending checks should remain proportionate to risk. We note that improving the timeliness of credit information and simplifying access would support smaller affordable credit providers to reduce administrative costs.

In terms of the role the FCA can play, meeting gaps in supply has tended to be treated as a challenge of scaling up existing affordable credit products rather than a process that begins with understanding the nature of unmet need and developing a strategy to address that need. We still lack a comprehensive and authoritative segmentation of unmet need for affordable credit to guide FCA and government policy. As we noted in our response to the credit information market study call for evidence, we would like to see the FCA use its access to credit information to develop such a segmentation and update it on a regular basis.

One further opportunity we would like to see the FCA explore is how affordability and creditworthiness processes can be used alongside credit information to disrupt unaffordable lending patterns. At present, being turned down for a loan can lead borrowers experiencing difficulty to a search for an alternative, often in a state of anxiety, increasing the likelihood of taking out credit not suitable for their circumstances.

**Q7: Please provide evidence and/or views on:**

- a. the main areas of change, innovation and growth in the supply of unsecured credit**
- b. the key pressures and challenges to the sustainability of firms supplying unsecured credit, including how these have changed over time and how they might develop in the future**
- c. new and emerging business models, including those making use of behavioural biases and income from other sources than the end consumer (eg employers, retailers), and how existing models may be adapting to change**

**Q8: Regarding unregulated credit or credit-like products:**

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

This review has drawn particular attention to point of sale buy now pay later (BNPL) products and wage advance services:

*Point of sale BNPL*

Debts directly linked to point of sale BNPL remain a very small proportion of debts held by StepChange clients. However, the number of these debts appears to be rising and we are concerned by this trend, particularly in light of the disproportionately high number of under-40s among advice clients.

Point of sale BNPL products have a behavioural impact on spending decisions and are marketed to retail firms as such. There appears to be some tacit acknowledgement from point of sale BNPL firms that these products do impact the regulated credit space; for example, through reporting of defaults to credit reference agencies. Soft credit checks likely reflect the need to limit defaults but speak to the need to check affordability. We note that a voluntary code of practice is being developed by industry firms although the details and sign-up to the code are unclear at this stage.



While the absence of interest charges means there is in principle an incentive for firms to avoid bad lending, firms do not have the same obligation as regulated credit providers to avoid *unaffordable* lending (as opposed to lending that is not creditworthy). The interests of consumers and firms are not therefore aligned. Moreover, firms can profit from customers through late payment fees and, in comparison to disclosure requirements for credit products, the potential cost of late payment is less transparent to consumers. Displacement to other forms of borrowing could shield firms from defaults.

Point of sale BNPL functions as a form of retail incentive. We note that in 2011, in response to concerns raised about the ease with which customers are tempted into expensive credit by retailers offering discounts on their purchases at the time they take out a store card, retailers agreed to end the practice of introductory discounts and ban the practice of offering direct commission to sales staff.<sup>7</sup> Our impression is that this agreement has been ineffective in de-linking retail incentives from credit as discounts and other forms of incentive remain common practice among online retail firms. Retail credit remains a significant driver of difficulty, particularly among younger people and those experiencing mental health problems.<sup>8</sup>

Our understanding is that the majority of point of sale BNPL transactions are 0% interest where the amount due is paid later as a lump sum or in instalments. We note, however, that several point of sale BNPL firms also offer interest-bearing credit products. This means that BNPL options have the potential to be part of a chain of decisions that lead to access to credit either directly (payment is deferred through point of sale BNPL and, when payment is due, rolled into the balance of a revolving credit product offered by the BNPL firm) or indirectly through another credit product.

While the late fees charged by point of sale BNPL firms currently appear limited, if conditions in future are less benign for firms, for example through competition that drives down the transaction fees paid by retail firms, they may become a more important source of income for BNPL firms. This could drive higher costs and repeat charges and increase risks of harms for consumers.

Point of sale BNPL products have grown quickly in scale in the UK and evidence of the interaction between these products and financial difficulty is limited. However, it is clear there are several ways point of sale BNPL has the potential to cause detriment for consumers, that there is a relationship between these products and the regulated credit space, and that firm incentives may drive product design that is to the detriment of consumers. Given these concerns, we suggest the FCA conduct a more formal evidence-gathering exercise and, making reasonable assumptions about continued growth of BNPL in future, review of point of sale BNPL alongside other retail incentives and make recommendations for government on appropriate regulatory changes to meet consumer protection objectives.

Questions that should be considered include:

---

<sup>7</sup> HM Treasury and Department for Business, Innovation and Skills (2011) *Personal Credit and Personal Insolvency Review: Formal Response on Consumer Credit*.

<sup>8</sup> Money and Mental Health Policy Institute (2017) [Buy now, pay later: Problems in the point sale credit market](#)

- What gaps and limitations exist in the regulatory framework that undermine consumer protection objectives?
- Are BNPL creditworthiness checks effectively ensuring deferred payments are affordable for consumers?
- How is point of sale BNPL affecting financial difficulty?
- How is point of sale BNPL affecting trends in regulated credit use?
- To what extent are the costs of point of sale BNPL transparent?
- To what extent are retail incentives including BNPL driving consumer harms?

#### *Wage advance services*

We also note the increasing presence of different forms of wage advance or wage smoothing products. The below table sets out details of the principle services working at scale we are aware of. There do not appear to be any costs to employers and firms generate their returns by charging a fee for wage advances, interest on loans or subscription fees.

<b>Provider</b>	<b>Market information</b>	<b>Services</b>	<b>Fee for advance</b>
<a href="#">Hastee</a>	Range of employer case studies, seem to be outside 'gig-economy'	Wage tracking, wage advance	£100 free then 2.5%
<a href="#">Salary Finance</a>	Estimated 1 in 10 employees linked to SF in some way across 500 (mostly large) employers. Now supporting more public sector employers and employees (e.g. 380,000 from the NHS) than previously.	Loans, savings, wage advance	£1.49
<a href="#">Wagestream</a>	Good coverage in hospitality and 'casual dining' employee sectors.	Stream wages, track wages and financial education, savings	£1.75
<a href="#">Trezeo</a>	Target market: gig workers and other self-employed.	Income smoothing salary top-up credit, personal accident insurance, credit	£3 p/w subscription for basic membership up to £10p/w with add ons

<a href="#">Steadypay</a>	Targeted at people working variable hours, but marketing terminology refers to 'gig economy', which is potentially confusing.	Loans, savings, wage advance, wage tracking	4 p/w subscription
<a href="#">Salad Money</a>	Available to NHS employees only	Loans	15 day interest free salary advance

There is little published independent evidence on salary advance schemes, so it is hard to make a judgement on their impacts at this point. There is a considerable range of services provided depending on the target group, from more financially vulnerable workers with fluctuating income to employees with stable monthly wages. The individual context of each scheme is important in understanding risks.

The products are marketed as replacements for dangerous high cost credit products like payday loans, allowing people to avoid the cycle of debt that comes with expensive interest rates. Most providers also claim to improve well-being generally by allowing people to have a better grasp on their financial situation through budgeting tools and savings options, including in some cases direct transfer of wages to a Help to Save account. If providers have strong safeguards against unaffordable or repeat borrowing, a number of these products do appear to offer a helpful service to employees that can help prevent and reduce financial difficulty.

We nevertheless agree with the FCA's assessment that these products also carry some risks such as a lack of effective affordability checks, a lack of transparency about cost, potential harms associated with dependency and repeat use, a lack of credit information visibility and default priority that may not be in the borrower's interest.<sup>9</sup> Risks of poor outcomes are higher for certain groups of employees such as those with low financial literacy, in or at risk of poverty, or with a fluctuating income. We note particularly that wage advances affect income tax, national insurance and assessment of earned income for Universal Credit payments and may prompt significant unexpected fluctuations in income that could cause or contribute to financial difficulty. Employers may not be effective in assessing the suitability and benefits of products, particularly if they have less strong connections with workers and employees. Risks of poor lending outcomes appear highest where products are targeted at 'gig economy' workers who whose income is unpredictable.

The FCA regulates revolving credit products such as personal banking overdrafts and credit cards that do not necessarily bear interest charges. Wage advance products bear a close resemblance to these regulated product categories. Alongside potential risks, this suggests consideration should be given to regulating aspects of wage advance schemes (where this is not already the case). This

---

<sup>9</sup> Financial Conduct Authority (2020) [FCA sets out views on Employer Salary Advance Schemes](#)

review may help surface evidence of the use and impact of these schemes. We suggest the FCA builds on the review with a more formal research-led evidence-gathering exercise: we do not see point of sale BNPL and wage advance services as sitting in the same consumer space, but there is clearly potential to assess the need to extend the scope of the FCA's regulatory remit through a single exercise of this kind.

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

There are examples where the FCA's response to substitutable unsecured credit products has been inconsistent. StepChange has welcomed FCA measures put in place in response to evidence gathered and analysis conducted through the high cost credit review, including the ban on unauthorised overdraft fees and rent-to-own price cap. These measures broadly reflect a concern with outcomes for financial vulnerable consumers using products that tend to be used to meet cost of living pressures and carried a high risk of harm through long-term over-indebtedness and high costs. These interventions do, however, leave a landscape in which consumers with similar characteristics enjoy different levels of protections using other products with similar risks.

Within StepChange's advice client group, we have noticed particularly that high risk 'subprime' credit cards are commonly held by those in financial difficulty, are typically used to make ends meet or manage financial difficulty by making credit repayments, and carry a significant risk of harmfully high costs.<sup>10</sup> These risks warrant interventions such as more effective affordability rules and guidance for credit cards, an end to a repayment framework that exploits behavioural bias and limits on prices.

High risks cards appear to have avoided close scrutiny due to the sequencing of the FCA's work, with the 2015-2017 credit card review pre-dating the high cost credit review. We understand why the FCA has taken a thematic product-based approach to its work, but this method has led to inconsistency. We have yet to see evidence of the early impact of the persistent debt rules arising from the credit card market study, but it appears applying a one-size fits all approach to a diverse credit card market has worked least well for those in financial difficulty, driving increases in minimum payments at the wrong times for customers without fully addressing excessive costs in the high risk segment.

In principle, the FCA's new vulnerability guidance has the potential to drive improved outcomes by requiring firms to understand and respond to risks for customers with vulnerable characteristics, including in product design. However, it is not clear the guidance involves any requirement to review existing product design and, because it has not been integrated into the regulatory framework through specific requirements in rules, its impact on products like high risk credit cards that carry clear risks to financially vulnerable consumers may be limited.

We remain of the view that a duty of care for financial services would help to drive consistent regulatory outcomes and ensure that a focus on good outcomes for vulnerable consumers is embedded in firm culture. It would make explicit that firms should not seek to profit from consumer

---

<sup>10</sup> StepChange Debt Charity (2019) [Red Card: Subprime credit cards and problem debt](#)

vulnerability, biases or constrained choices. In particular, it would embed the concept of care and fair treatment of consumers at the highest level of the regulatory framework.

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

We would expect changes in regulation to change firm incentives toward good consumer outcomes, if regulatory policy intervention is to have any preventative effect.

This may seem an obvious point, but the long history of consumer credit regulation in the UK highlights how ineffective regulation can incentivise and even embolden firms to engage in (sometime egregious) bad practice. Given the wide-ranging nature of this review, and the parallel HM Treasury review of financial services regulation, it is perhaps worth briefly reflecting on this history.

The pre-FCA regime was characterised by low barriers to entry (including poor oversight and control of business models), limited conduct oversight and sanctions, limited policy authority of the regulator and an overemphasis on consumer information. The Consumer Credit Act (CCA) and Office of Fair Trading regime was underpinned by a view that competition, innovation and diversity in suppliers would lead to good consumer outcomes. The parade of successive problems causing widespread consumer detriment as credit markets expanded rapidly in the 1990's and 2000's demonstrated this was not always the case.

StepChange has argued previously (in our responses to the Duty of Care consultation) that in the absence of effective regulatory policy, some firms will be incentivised to profit through exploiting consumer vulnerability, behavioural bias and constrained options. We note that work by the FCA has highlighted how this can take different forms.

The FCA's 2013 occasional paper on behavioural economics pointed out that firms may unknowingly (or knowingly) exploit consumer biases (or mistakes arising from these) in a way that delivers bad consumer outcomes. The paper suggested this effect may be particularly pronounced in poorly functioning markets.

The FCA's high cost credit review found examples of consumers facing excessive prices and other problems, in part because their circumstances left them facing constrained choices in the credit market. This was elegantly articulated in the CP18/35 rationale for a proposed rent-to-own price cap that 'we need to intervene in the RTO market because a highly vulnerable group of consumers are paying too much for household goods'.

In the years since the FCA was given responsibility for consumer credit we have seen a number of welcome interventions to address long standing areas of consumer detriment (including unauthorised overdraft charges, persistent credit card debt and payday lending). Each problem had roots in incentives that misaligned the interests of firms and (at least some of) their customers. Each intervention aimed to mitigate or realign those incentives to some extent.

So it seems clear that the FCA, consumer advocates and firms know (or ought to know) a good deal about the relationship between regulation and incentives, at least from the perspective of the consumer protection objective.

That said, these interventions have largely been aimed at already widespread and sometimes longstanding problems. ***We believe one of the functions of this review should be to look at how well remedies designed to deal with these problems are working to change incentives and eliminate consumer detriment, and to consider how transparency on progress towards clearly stated policy objectives might hasten and embed change in the way firms think about incentives that may drive consumer detriment.***

The FCA's consumer protection objective is also forward looking, aiming to prevent new forms of harm from developing. It is not at all clear that existing high level principles and overarching approaches (like the Senior Managers regime or the treating customers fairly outcomes) have provided a clear and effective governance framework, with specific and targeted rule-based interventions still needed to deal with long-standing problems.

While past experience suggests specific and targeted rules will always be needed, a key question for this review is to reflect on how well the regulatory framework governs innovation, ensuring that new products and services do not exploit consumers' vulnerability, behavioural bias or constrained choices.

We can see elements of such a governance framework in the draft vulnerability guidance (particularly 4.3 (design), 4.6 (potential for exploitation), 4.13 (considering needs at all stages), 4.20 (testing) and 5.8 (using management information) and through initiatives like the regulatory sandbox and the digital sandbox that give firms a better opportunity to understand regulatory expectations before bringing products to market. However, we believe that there is scope to improve the way regulatory expectations on the consumer protection objective are articulated, and we hope that the forthcoming duty of care consultation will pick up on this.

We have previously argued that the FCA should adopt a duty of care to help provide a better governance framework for financial services innovation that is capable of preventing the repeated problems we have seen with consumer credit in the past. We called for such a duty of care to include a 'fair by design' principle (building from the vulnerability guidance and setting a stronger expectation) and a principle that firms should not profit from exploiting consumer vulnerability, behavioural bias or constrained choice.

***We would also like this review to consider how to actively incentivise the development of products and services that align with the interests of consumers who are vulnerable to debt and other harm from using existing credit products.*** The consumer protection objective charges the FCA with ensuring financial products and services do not harm consumers. This is not the same as ensuring that products come to market that are aligned with the interests of vulnerable consumers.

It is clear that financial services, including unsecured credit are currently meeting key needs (such as purchasing essential goods, meeting emergency expenditure or coping with income shocks) that have broader social welfare implications. However, risk based commercial credit products can be a harmful way of meeting these needs. There is therefore a tension between regulatory and public policy that cannot be easily resolved without a broader strategy to consider how financial services

products (credit and protection products, for example) can better meet social policy objectives. We hope that this review can reflect on the need to articulate this tension for other policy makers.

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

We have touched on parts of this question in our response to question 11. Here we will briefly set out a (non-exhaustive) list of changes in the market that could drive incentives that do not align with consumer interest:

- A decline in consumer protection standards as a result of the CCA remaining provisions review, the HM Treasury financial regulation review, or this review could incentivise firms to harm the interest of consumers knowingly or unknowingly
- There are a number of ways that new technology could create incentives that work against the interest of consumers, or particular groups of consumers:
  - New products and services could recreate old problems in a new way that is harder for regulation to control. For instance, some years ago the store card sector committed to stopping certain retail incentives to use store card credit. New buy-now-pay-later services could reintroduce similar incentives in a different way, but the greater distance between the purchase and the credit (card payment linked to overdraft credit for instance) may make point of sale incentives harder to regulate.
  - Online access to credit and goods/services funded by credit reduces 'friction' in consumer decision making that may create conditions for vulnerable credit use for some consumers.
  - New data and decisioning technologies may further exclude some consumers or introduce untransparent bias into processes like lending decisions.
- Market conditions may alter lenders' risk appetite in a number of ways that incentivises behaviours that have harmful results for consumers, from increasing prices and tightening lending criteria (financial exclusion, mortgage prisoners etc) to over-loosening lending standards and incentivising products that exploit financially vulnerable consumers.
- Macro conditions (such as current Covid response) putting pressure on firms' capacity and returns could weaken conduct standards in collections and incentivise more aggressive recovery strategies.
- Financial difficulty can incentivise consumers' distressed use of credit, which while potentially profitable for firms, is harmful to consumers in the longer-term. Macro-economic changes (like current coronavirus crisis), social policy changes (adequacy of other available safety nets to cope with income shocks) and technology (continuous payment authorities reducing collections costs and risks) could all drive this dynamic in different ways.

**Q13: Please provide evidence and/or views on the current level of cross-subsidisation between different consumers in the unsecured credit market. What forms of cross-subsidisation are compatible with a healthy credit market?**

Some degree of cross-subsidisation within products is an inevitable part of commercial credit. Cross-subsidisation becomes problematic when it is unfair and/or leads to harmful outcomes for consumers. We note that in recent years the FCA has looked at, and did not find significant evidence of, this type of cross-subsidisation in the credit card market and personal banking overdrafts. However, in the former case the FCA took a high-level market perspective and does not appear to have looked closely at some products where it might be expected the potential for cross-subsidisation within products at the expense of vulnerable customers is high. Simplification of overdraft fees stands to benefit the majority of people in financial difficulty but may over time increase segmented, risk-based pricing of overdraft products with higher costs falling on some consumers.

We are particularly concerned about indications that business models underpinning high risk credit cards depend on a cohort of customers paying high interest costs through long-term repayment patterns and that these patterns are most likely among those who are struggling. We have noted in our own work that persistent debt rules do not prevent high costs—potentially in excess of 100% of the amount borrowed—from emerging. This raises the prospect that the viability of some products in their present form depends on profiting from customers in financial difficulty.

We welcomed the FCA's decision to require firms offering cards to low income customers or those with poor credit ratings to review their prices to consider whether they are consistent with the obligation to treat customers experiencing temporary difficulty fairly in the light of the exceptional circumstances arising out of coronavirus.<sup>11</sup> This seems to reflect an acknowledgement that charging customers in difficulty high prices contravenes principle six. We would now like to see the FCA focus particularly on high risk products in its review of the impact of persistent credit card debt rules and other early intervention measures implemented following the credit card market study.

The FCA's new vulnerability guidance also has some potential to influence change, for example through its expectation that firms design products and services to avoid potential negative impacts on vulnerable customers. As we have set out, however, it is not clear this guidance has the regulatory force to drive a transformation in entrenched market-wide firm practices. A duty of care embedded in rules would establish a regulatory lever to end cross-subsidisation that occurs to the detriment of customers who are financially vulnerable.

Our view is that a revolving credit model that is responsible and fair to those who are financially vulnerable must include a repayment structure that, by default, minimises costs rather than, at present, extends repayment and increases costs; offers a safe way out of persistent debt before harmfully high costs emerge; and includes limits on total costs that prevent harmfully high costs outright.

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

---

<sup>11</sup> 'Expectations in relation to credit card rates' in Financial Conduct Authority (2020) [Credit cards \(including retail revolving credit\) and coronavirus: temporary guidance for firms](#)



*Credit information:* The FCA's credit information market study is still due to report and our submission to that review highlighted a number of issues with credit data that can cause problems for consumers:

- It is not clear that credit history data is particularly effective in ensuring responsible lending; our *Red Card* report on the sub-prime card sector found lending to people already facing financial difficulties and over three quarters of StepChange clients surveyed saying a sub-prime card had a negative impact on their financial situation. This may also be a problem with the way information is being used by lenders in decision making rather than solely a result of gaps in information.
- Some lenders may modify agreements allowing lower contractual payments without reporting missed payments to CRAs and some may not (suggesting that the integrity of credit data may already be compromised in a random and untransparent way). Lenders may offer forbearance but report info to CRAs in different ways and at different times.
- StepChange clients cited worries about the impact on their credit status as a reason they delayed seeking advice about financial difficulties. A combination of uncertainty about the pay-offs, or asking lenders for help and inconsistencies in the way that lenders treat and report missed payments can drive potentially harmful consumer behaviour, like borrowing more to try to keep up with existing credit commitments.
- It is not clear that credit history and credit scores fairly reflect the payment behaviour of borrowers. For instance, we understand that where a 'default' is entered on a consumer's credit record (perhaps after a temporary income shock) this may significantly affect their credit status for up to six years; with subsequent payment behaviour (keeping up payments on a debt management plan) having little positive impact.
- We note that Open Banking data rests on the principle that consumers should consent to use of their data and have control over the way their data is used. It is not clear that either of these principles are operating effectively with credit history data.
- It is not clear how well lenders are using available information to identify early stages of financial difficulty, or whether the market as a whole is getting better at this.
- StepChange has raised the need to offer those who have experienced negative credit reporting events a fair way to use positive repayment behaviour to rebuild their credit history within a reasonable period without resorting to interest-bearing credit products and particularly high risk credit builder products.
- Credit reference agencies are embedded in market structures but operate in ways that seem to be unsatisfactory for both consumers and market participants. Limits and inconsistencies in data are likely to undermine effective lending decisions and early intervention. We have noted that the need to use data from multiple agencies increases costs to firms and that this is a particular challenge for affordable credit providers: it is not clear how much value duplication of data collection adds for consumers or firms. The Steering Committee on Reciprocity shapes credit data standards and sharing but offers no consumer representation and little

transparency—if there are opportunities to improve the content, gathering and sharing of credit information it is not clear how these would be pursued.

In light of these issues, we would ask this review and the credit information market study to consider whether the governance of consumers' credit information data is currently working in the interest of consumers, and how it can be reformed to do so.

**Debt solutions lead generators:** Stepchange has repeatedly highlighted the problem with misleading promotions and other misleading information practices lead generators in the debt solutions market. The broad regulatory framework for the debt solutions market has been slow to address this ongoing problem, possibly because lead generation for debt solutions is still not a regulated activity. The current Financial Services Bill provides an opportunity for the government to address this.

**Open finance and new data technologies:** We note the recent FCA consultation on open finance and firms' increasing use of new data technologies to develop products and services. A consumer protection gap could open in the absence of a clear regulatory governance framework capable of ensuring new data technologies work in the interest of consumers.

**Q15: Please provide evidence and/or views on the impact of Covid-19, both now and as you expect it may play out in the future, on:**

**a. the demand for different types of unsecured credit**

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

Our recent report on *Tackling the coronavirus personal debt crisis* highlighted the financial impact of the pandemic and evidence of the deepening financial difficulties being experienced by a large number of people.<sup>12</sup> The report estimates some 15 million people have been negatively affected by the coronavirus crisis and nearly three million of this group are at high risk of long-term debt problems.

The report found the most common financial coping strategy among those affected negatively by coronavirus is borrowing to make ends meet (33%), followed by using savings (23%), asking family and friends for help (15%), applying for Universal Credit (10%) and selling items (10%).

We estimate that nearly 5 million people negatively affected by coronavirus have borrowed to make ends meet, with estimated 'survival' borrowing since lockdown in March totalling £6.5 billion. Credit cards and overdrafts were most commonly reported, followed by borrowing from family and friends. We estimate that 9% of those affected by coronavirus have used one or more forms of high cost credit to make ends meet since the beginning of the outbreak (compared to 4% of those not affected). However use of high cost short term credit appears to have declined between May and September.

---

<sup>12</sup> StepChange Debt Charity (2020) [Tackling the coronavirus personal debt crisis](#)

Our *Life Happens* report highlighted how using credit as a safety net to cope with income shocks can significantly increase the risks of falling into serious problem debt later on.<sup>13</sup> For instance, people who used credit cards or an overdraft to cope after a life event were ten times more likely to be in problem debt than those who got by without using them. Our previous research found that using high cost credit to cope with a life event increased the likelihood of experiencing problem debt even further.

It is not clear that the coronavirus emergency has yet had an impact on the broad supply of credit per se. Aggregate data on outstanding consumer credit borrowing shows a decline of around £18 billion between February and September, but this is likely to reflect both a steep decline in economic activity affecting demand and (as has been widely reported) the ability of some households to pay down debt or build up savings. This may change, and we note the long decline in outstanding consumer borrowing between 2010 and 2012 followed by recovery to the pre ‘financial crash’ peak in 2017.

We would make the following observations on sustainability, affordability and gaps in provision:

- The coronavirus crisis has highlighted again the point that we made in our *Life Happens* report that a large number of UK households do not have insufficient financial resilience to cope with an income shock without using credit as a safety net. ***Given that this coping strategy significantly increases the likelihood of problem debt, we would ask this review to consider alternatives to this credit safety net.***
- Some possible alternatives (such as non-commercial no interest loan schemes) will be outside the scope of regulatory policy but highlighting the problem in this review will help focus the broader public policy debate.
- Likewise, our coronavirus impact polling found a small but significant (2%) group who said they were using unlicensed lending to make ends meet. The review will hear arguments that FCA regulation of high cost credit should be relaxed to increase access to legal credit for people vulnerable to illegal lending. However, high cost credit is also likely to be harmful to financially and otherwise vulnerable people. Indeed, our January 2020 report of StepChange clients’ experience of working age benefits found 10% of respondents saying they had used an unlicensed lender as a result of problems with their benefits. This suggests that unlicensed lending is being driven more by financial vulnerability and failing safety nets than over-regulation of high cost credit that is also potentially harmful to this group.
- That said, it is within scope of the regulatory framework to consider how lenders might better help customers deal with credit payment difficulties following a life event. The popularity of FCA-mandated payment deferrals shows how a clear offer of help with temporary difficulties (that does not impact on credit status) encourages consumers to engage. We note that in the past lenders offered payment protection insurance to support borrowers (and their own lending book) through periods of financial difficulty. ***The significant flaws with PPI products are of course well understood, but we would ask this review to consider how lenders***

---

<sup>13</sup> StepChange Debt Charity (2019) [Life happens: Understanding financial resilience in a world of uncertainty](#)

***might be required to build a better ‘hedge’ against life events into credit products to benefit consumers rather than provide a revenue stream for lenders.***

- We note that the coronavirus crisis may result in a new cohort of consumers becoming financial excluded, falling into persistent debt with revolving products or both. ***We urge this review to consider whether the credit card persistent debt and overdraft repeat use rules need strengthening to prevent a new cohort of people falling into persistent debt.*** We believe the FCA should publish regular data on the progress and effectiveness of the persistent credit card debt and repeat overdraft use remedies.
- ***Finally, we would ask the review to consider what measures the FCA might take to minimise any financial exclusion for people financially affected by the coronavirus crisis.***

**Q16: Do you think the impact of Covid-19 presents new or unique challenges for the unsecured credit market, or has it just emphasised or entrenched existing issues?**

The evidence we have seen so far suggests that the coronavirus crisis has exposed pre-existing problems of low household financial resilience, insecure incomes and safety nets that are not always adequate. Therefore we believe coronavirus is likely to largely emphasise and entrench existing issues for the unsecured credit market. However, the nature of the coronavirus crisis has highlighted the weakness of the forbearance framework (even as amended by guidance) to deal with temporary financial difficulties.

**Q17: Do you think any of the measures set out in the FCA’s temporary guidance for consumer credit, including those related to credit information and forbearance, or the FCA’s wider approach have broader relevance to customers in financial difficulty more generally?**

StepChange welcomed the temporary guidance and subsequent updates as timely and necessary help for borrowers struggling with credit payments as a result of the coronavirus crisis. However, our August response to the FCA call for input on ongoing support for consumers affected by coronavirus, and our responses to guidance consultation, highlighted a number of issues that have relevance to customers in financial difficulty more generally:

- We said that we do not think the forbearance framework works well for customers in temporary financial difficulty. While the guidance sets out general considerations and requirements for lenders, it does not give borrowers a clear and consistent message about the payoff from asking for help. Unlike the payment deferral periods, the guidance was clear that forbearance would follow normal credit reporting. However, it is not clear why a six month freeze on credit reporting is the right level of support, rather than 12 months (which is the common period of support given by lenders under PPI policies) or some other period. We understand that creditors will need visibility on evidence of possible financial difficulty to inform their lending decisions, but the current system of CRA reporting appears capable of impacting on credit scores for longer than the period of temporary financial difficulty. Our client research found that consumers will delay seeking help because of worries about their credit status and

this may incentivise potentially harmful behaviours like borrowing more to keep up with payments.

- For people in temporary difficulties with multiple credit agreements with different lenders the forbearance framework and related credit information reporting requirements can create difficulties. Not all lenders will necessarily interpret the guidance or response to requests for help in the same way. As noted, some lenders may modify agreements allowing lower contractual payments without reporting missed payments to CRAs and some may not (suggesting that the integrity of credit data may already be compromised in a random and untransparent way). Lenders may offer forbearance but report info to CRAs in different ways and at different times. ***So we urge the review to consider how the forbearance guidance and CRA reporting guidance might be better connected to minimise the potential for financial exclusion for people facing temporary difficulties.*** There is a related and larger issue here on how income shocks can create and entrench financial exclusion and whether the unsecured credit market delivers fair outcomes for people recovering from financial difficulty in terms of both price and access to affordable credit.
- Payment deferral periods were attractive to consumers with a clear offer of help, but could allow debts to build up, including further default interest. We questioned whether charging default interest at the agreement borrowing rate was a fair business practice, as this is broadly equivalent to new lending for a period when the borrower is in financial difficulty. Parts of the temporary guidance (second charge mortgages for instance) recognised that default interest can become a problem, asking lenders to consider reducing default interest or setting this to zero. However, this was not a requirement and not generalised throughout the temporary guidance. This concern remains outstanding.