Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Financial Services Consumer Panel: research report on early-stage consumer credit journeys

About the Panel

The Financial Services Consumer Panel (FSCP) is an independent statutory body set up to represent the interests of consumers (both individuals and small businesses) in the development of policy for the regulation of financial services. We are listed on the European Transparency Register[1]. Members of the panel are recruited via open competition and have a range of experience including consumer advice, financial services industry, communications, campaigning, financial inclusion, market research, journalism and the law.

Acknowledgements

This Report is issued by the Financial Services Consumer Panel; we commissioned Britain Thinks to conduct the accompanying research.

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Helen Charlton
Chair, Financial Services Consumer Panel

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[1] https://ec.europa.eu/info/about-european-commission/service-standards-and-principles/transparency/transparency-register_en

Executive Summary

Consumer credit is an important component of any well-functioning economy but excessive or inappropriate use of consumer credit and unfair terms can cause consumer detriment. While we have a good understanding of the harmful impact on individuals and society of heavy or prolonged credit, the early stages of people's credit journeys are less well understood. By improving our understanding of consumers' early relationship with credit products, we can seek to prevent at least some of the harm. With this in mind we commissioned Britain Thinks to research consumer decision making in the early parts of the credit journey.

In this paper we look at how actual and potential harms might arise from people's earliest use of credit and suggest a range of interventions to address them. Some of these proposed interventions fall to the FCA for consideration, particularly in light of the forthcoming new Consumer Duty, whilst others will require cooperation among regulators. These proposed interventions can improve the financial resilience of individuals and give rise to a multitude of benefits to society as a whole.

Research methodology

A qualitative research approach was preferred due to the need to gain a deep understanding of consumer behaviours and attitudes. It was decided to focus on emerging forms of credit where much was not known, such as BNPL, Higher-Cost Credit, peer-to-peer lending and informal lending. A total of 40 in-depth interviews were held with borrowers who owned one or more of the credit products of concern and who were either just starting their credit journey or were slightly more experienced users of credit. Interviews were held between March and May 2022. Qualitative methodologies give a rich picture of the research topic in terms of behaviours, motivations and attitudes, but cannot tell us the extent to which the findings are reflective of the wider population. This is reflected in our recommendations, which include several calls for further investigative work.

Importantly, the field work was conducted at a time when people and businesses were looking forward to resuming pre-covid activity, and when the current cost of living crisis was still a future worry rather than a harsh reality. We were already seeing rising spend on credit cards, a continuing decline in real incomes, concerns about energy costs and an increase in mental health difficulties.

Main findings

1. Three consumer typologies emerged from the interviews: 'Engaging', 'Normalising' and 'Surviving'. These were not rigid and borrowers could move from one to another depending on their life situation or the credit product they were acquiring. Those 'Engaging' with credit thought carefully before taking out new lines of credit and used it in a positive way. Those 'Normalising' credit used it without thinking so critically about immediate choices or long-term consequences. Finally, there were those who were only 'Surviving' from pay-day to pay-day by using credit and were perhaps the most vulnerable in this study.

2. A key component of these typologies were the mindsets of the borrowers. Those with a 'functional' mindset borrowed chiefly based on need and a desire to be financially responsible. 'Social' minded credit consumers were informed by peers and social networks as well as their values. Those who borrowed with an 'emotional' mindset seem particularly vulnerable – they had a fear of missing out and tended to use credit reactively, or even impulsively. When

faced with algorithmic targeting on social media and online search, these borrowers can suffer real harm.

3. Many borrowers in the study believed that they were in control of their credit as long as they were making minimum contractual payments. They often did not have clear plans for clearing the balance. This lack of understanding clearly could lead to unmanageable and prolonged debt.

4. Use of credit products for the most part was not viewed as debt. Debt was seen as a problem that other people had, while outstanding credit was normalised by many, particularly where it was common in their reference groups. The reluctance to see early credit use as a debt obligation could also have implications for reaching out for help. Many advisory services use the label 'debt' and this may be a barrier for some in seeking early advice.

5. Borrowers in this study were subject to many push and pull factors in their decision making process. Pull factors included speed of access, a belief that the product will improve their credit scores, and discounts and vouchers. Push factors were mainly life situations such as unemployment and bereavement, but importantly also included the 'scramble to refinance' when an introductory or zero credit period had finished and the borrower was not ready to clear the balance. All these factors are particularly important for borrowers who are socially minded and/or of an emotional mindset.

Recommendations overview

1. The **FCA** and the **Money and Pensions Service** should develop ideas in the recent Occasional Paper on whether so-called Roboadvice[2] can help people make better repayment decisions.

2. The **FCA** should review persistent debt rules and conclude earlier work on the presentation of minimum payments in view of our new evidence of early users' sense that minimum payments equate to control over credit.

3. The **FCA** should research and enforce a better disclosure framework under the Consumer Duty. The FCA should not wait for the CCA Review to conclude before pushing through changes under the new Consumer Duty.

4. The **FCA** should research and propose what the key features are of a good consumer journey in terms of balance between easy access and protective friction.

5. The **FCA** should review consumer understanding of the way credit score improvement products work.

We would also be supportive of further research using real borrowing and repayment data to see whether regular re-financing is a forward indicator of financial distress. If supported by evidence, interventions could be considered.

Next steps

We would like the FCA to take action on the recommendations made in this paper, ensuring that the Consumer Duty is used wherever possible to change practices and hold firms to account, and working with other regulators where appropriate to drive improvements. The FSCP will continue to hold the FCA to

[2] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-61.pdf

account for protecting consumers and ensuring they are given the right information and support, in the right format and at the right time to make more informed credit decisions.

Chapter 1: Introduction

1. Background

1.1. Consumer credit is an important component of any well-functioning economy but excessive or inappropriate use of consumer credit and unfair terms of credit can cause consumer detriment. While we have a good understanding of the impact of heavy or prolonged credit use going wrong, the early stages of people's credit journeys are less well understood. The Financial Services Consumer Panel (FSCP) therefore commissioned Britain Thinks (BT) to take a deep dive into consumer credit journeys - with an emphasis on those at the beginning of their credit journey and with non-traditional consumer credit products. Non-traditional consumer credit products include high-cost credit, high-cost retail credit, informal/ unregulated loans and newer forms of credit such as Buy Now Pay Later (BNPL) and peer-to-peer lending. The aim of the research was to understand whether harms or risks of harm could be identified early in a consumer's credit journey, in order to inform discussions on how to prevent such harms.

1.2. This research was planned early in 2022 and the fieldwork conducted March – May 2022. The context is therefore optimism about "re-normalisation" after the COVID-19 pandemic combined with early concerns about what is now a full-blown cost-of-living crisis.

1.3. This economic backdrop is combined with a multitude of new innovative credit products, many made a reality by Open Banking technology and marketed heavily on social media, which appeal particularly to a younger generation with less experience of credit. This market behaviour may also increase take up of credit products, which in turn increases the risk of future difficulties.

- The devastating impact of **problematic debt** on people's lives has been documented elsewhere. StepChange's Life on the Edge report highlighted that 13 million people in the UK could not cover their essentials for one month if their income fell by 25%[3]. Additionally, there has been an increase in households with negative budgets as reported by Citizens Advice and the deficits on those budgets has worsened, moving from -£167 in 2016/17 to -£203 per month in 2018/19[4]. People with negative budgets may have no alternative but to use credit to make up for the short-fall in income.

- **Real earnings have declined 4.5%** in recent months[5] - the largest decline since comparable records began in 2001. These overall figures mask real hardship for some groups and work by the Institute for Public Policy Research (IPPR) on debt by ethnicity, showed that prior to the pandemic those of Mixed and Black heritage had higher levels of indebtedness compared to other groups and these groups also faced higher levels of unemployment

[3] https://www.stepchange.org/policy-and-research/life-on-the-edge.aspx

[4] Negative budgets refers to an excess of essential costs over income after a full review by a trained money adviser. https://www.citizensadvice.org.uk/about-us/our-work/policy/policy-research-topics/debt-and-money-policy-research/negative-budgets-a-new-perspective-on-poverty-and-household-finances/

[5] Office for National Statistics (April 2022)

due to COVID19. These groups were three times more likely than the average to have moved from employment to not working[6] during the pandemic, placing enormous pressure on their household finances.

- The pandemic was a time of **anxiety and mental stress** for many people and there has been a high demand for mental health services during and since. The link between debt and mental health has long been established. In some cases, mental health vulnerabilities are the reason for problematic debt and in others they dominate the aftermath. It is estimated that nearly 1 in 5 people with mental health issues are in serious debt[7].

- Meanwhile those **in problematic debt** are often recommended to seek help from debt advice services. The Money and Pension Service (MaPS) is charged with commissioning such services in England and have reported that 8.5 million people (1 in 6) need full regulated debt advice and a further 10.6 million are at risk of being 'tipped over' into needing debt advice[8]. MaPS has stated that it expects demand for such services to increase, resuming a trend seen prior to COVID-19 and the associated Government support schemes.

1.4. In the face of this changing market, the regulatory response has not been insubstantial. Over the last decade, the FCA has intervened to protect consumers across a wide range of credit markets, particularly high-cost ones. It has capped the price of pay-day lending and rent-to-own products as well as limiting the interest that can be charged on unplanned overdrafts[9]. Further interventions were also made in relation to motor finance, credit cards and guarantor loans. The FCA has recognised that action to stop unfair practices in these markets could leave those former customers without previously relied-on sources of credit. Most recently, the Government has moved to bring Buy Now Pay Later (BNPL) products into the regulatory framework[10] and before the legislation to do that is in place, FCA has taken action to improve the contractual terms of BNPL credit agreements, which were considered harmful to consumers[11]. However, this does not mean that more cannot be done to tackle potential harm, as we explore in our recommendations section later in this report.

2. Overall aims & methodology

2.1. It was against this background that the FSCP decided to take a deep dive into consumer credit journeys - with an emphasis on non-traditional

[6] https://www.ippr.org/blog/minority-ethnic-groups-face-greater-problem-debt-risk-since-covid-19
[7] https://www.moneyandmentalhealth.org/money-and-mental-health-facts/#:~:text=Almost%20one%20in%20five%20(18,mental%20health%20problems%20(5%25)
[8] https://moneyandpensionsservice.org.uk/2022/02/23/who-needs-debt-advice-in-2022/
[9] https://www.fca.org.uk/firms/high-cost-credit-consumer-credit/high-cost-credit-review
[10] https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf
[11] https://www.fca.org.uk/news/press-releases/fca-secures-contract-changes-buy-now-pay-later-customers

consumer credit products. To do this the Panel asked six research questions:

1. How do consumers fund their spending, and how does this vary by type of spending (e.g. essential Vs non-essential)?
2. To what extent is consumer spending funded by debt, what types of debt have they taken on, and why? Has this changed over time, and why?
3. To what extent are consumers' debt portfolios the result of informed decisions about their spending and debt, and how does this vary and change over time?
4. What factors influence consumers' spending and use of debt to fund spending?
5. To what extent do consumers think consciously about the range of different debt products they own?
6. Is there any evidence of potential consumer harm (even if this has not yet crystallised) in the early part of the debt journey, and what are the drivers of this?

2.2. The critical piece in this research is whether risks of harm could be identified early in the consumer credit journey with the hope that if successfully identified, it could be used to inform strategies and policies to prevent consumers from falling into problematic debt.

2.3. The Panel was particularly keen to focus on some of the newer forms of credit, such as BNPL and high-cost credit, as well as informal sources of borrowing and understand consumers' attitudes towards them. It was felt that a qualitative exploratory approach to the study would be better as it would give us the rich depth of insight to understand the mindset, the drivers and the behavioural components which will help to improve overall understanding of how to protect consumers. This type of research cannot say how many consumers are impacted by issues found. To do this, more research of a quantitative nature will be needed, and we have included this in our recommendations.

3. Rationale for research methodology

3.1. From a review of the literature, it appeared that much of the research on credit and debt focussed on consumers already in debt and looked at factors relating to the prolonged, heavy use of products. However, to understand whether potential harms could be diverted, it was important to look in depth at the beginning of the credit journey. The research took the form of in-depth interviews with 40 people who had the specific credit products which were the focus of the study. Many of the participants also used more traditional credit products such as credit cards and overdrafts and relevant findings about the acquisition and management of these products are included in this paper. The interviews were split between those who had just taken out their first credit product, and those who were slightly more experienced and might have two or three credit products but were still maintaining the necessary payments.

3.2. Further details about the methodology can be found in the Britain Thinks research paper published alongside this report.

Chapter 2: Key Findings

1. Normalisation of Credit

1.1. The fact that friends and colleagues were using certain types of credit and that it was regularly advertised on social media contributed to a feeling among the research group that credit was normal and that everyone was doing it. This was particularly true if they had friends and families who were in debt. Some were not even concerned if their utility bills (normally considered an essential) were in arrears and did not see it as debt. This was evidenced by a female respondent saying ***"No, I don't have any debt, which I'm quite proud of. I didn't go to university so I don't have any student loans. We're in minus on our electric, but isn't everybody?".***

1.2. Normalisation took two forms:

(i) Users of credit who had friends and family members using credit felt that borrowing was just part of life. They were quick to compare themselves to others and if they viewed themselves as in the same or a better position than their reference group, they did not perceive that they had a problem. Use of an overdraft facility was considered a normal 'rite of passage' in financial credit terms and for others they even **saw overdrafts as 'their money' and not as money owed**. Some dipped in and out of it as needed and rarely had a long-term plan to pay it all off.

(ii) Being part of a particular brand's loyal customers was also important for some in the study. Certain brands appealed to their mindset particularly if they saw them frequently on social media or at the top of Google searches. Having a credit card was also seen as normal, with some taking them out to build up their credit rating. A few in the sample would pay off the credit each month but many were making minimum payments and **felt a degree of control because at least they were making some payments rather than none at all**. One finding was the idea of borrowing from one's future self. This interviewee clearly saw his prospects in a good light and felt that he would be able to afford these borrowings in the future. It was typical of the optimism bias among many of the users of credit interviewed.

3. What is Debt?

3.1. Very few in the sample considered their outstanding balances on credit products as debt. Debt was a 'dirty' word describing other people with problem debt. In contrast their own position and portfolio of credit products was viewed optimistically. If they were making their minimum payments then they could be assured that they were in a sound financial position. This was particularly true of those in the earliest stages of their credit journey.

3.2. As borrowers mature along the journey, acquiring more credit products and starting to find maintaining payments more difficult, there appeared to be a gradual awakening to the fact that they were in debt.

3.3. In the sample interviewed, those who were further along the credit journey were utilising credit more for 'essential' expenditure than 'non-essential', suggesting a danger of not realising that you are in debt until things have become more difficult, complex and time-consuming to rectify.

3.4. The reluctance to see themselves as in debt earlier in the credit journey could also have implications for reaching out for help. Many advisory services use the label 'debt' and this may be a barrier for some in seeking early advice.

4. Essential Vs Non-Essential Spending

4.1. What quickly became clear from the interviews is that except in a few cases, many of those interviewed had a broad interpretation of what is considered essential spending. What normally may be deemed as non-essential, e.g., nights out or new clothes, were seen as critical to maintain a good lifestyle. Many inferred that having treats to look forward to was influenced by their social circle and helped them to keep mentally strong. This has to be seen in the aftermath of the Pandemic where the public were denied the opportunity to shop and socialize.

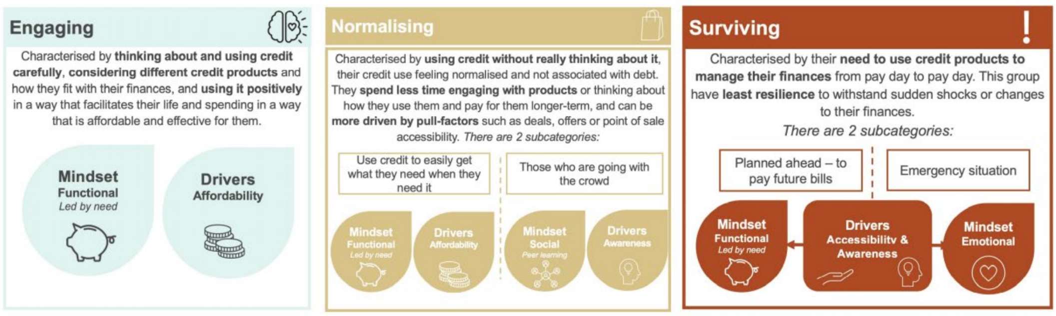
4.2. During the interviews, when pushed, borrowers could reason that an item was not essential but there was a definite reluctance to give it up, sentiments such as "It's probably understanding the difference between want and need, but it's hard" were not uncommon.

4.3. However, when those interviewed were asked to consider essential Vs. non-essential spending against the backdrop of the mounting cost-of-living crisis, many mentioned items that they had already given up or were prepared to give up to ensure that essentials were paid for.

4.4. In the pool of those interviewed there were those who held more traditional views on what constitutes essential spending. Mention was made of obtaining credit to spread the cost of larger ticket items, such as replacing a broken down washing machine. Here the interviewee decided to split the cost over a 3-month period funded by a store card.

5. Mindset

5.1. The decision-making process around taking out and managing a credit product is, the work shows, varied and personal. But three broad typologies emerged from the interviews.



5.2. These typologies are fluid and an individual can move between them depending on circumstances. A key component of the typology was mindset.

- People who had more of a **'functional' mindset** borrowed first and foremost on need. They had a desire to be financially responsible. Consumers in this group would tend to compare different products before making a decision and take into account their existing portfolio of credit products before borrowing more. They also would consider their longer-term financial goals and how this product may help or detract from those. Based on their approach to debt, as exposed in this research, many in this group appear less likely to end up with problem debt. However, the risk is not zero as the mindsets were not rigid and it was found that a consumer can have one mindset when considering one type of credit product but change completely when considering another.

- **'Social minded' credit consumers** are more informed by learning from peers and social networks as well as their values. Many did not want to miss out on products that they had heard a lot about. The 'need' driver for credit was not as strong in this group but rather there was a 'want' for a product. for these types of borrowers the journey to heavier credit use can be very short, and so there is less time to intervene to ensure that they are making the right decision - such as a 'cooling off' period in more traditional loan models.

- There is a strong **'emotional' element in the mindset** of some borrowers. Their decision making about credit tends to be more impulsive and based primarily on a desire to have the goods that they want with the least amount of friction. This group also tends to be more short-term in their thinking and do not dwell on the longer-term implications of the credit product. When this type of behaviour is combined with those who are just surviving from pay cheque to pay cheque, the dangers are clearly evident.

6. Pull and Push Factors in acquiring credit

6.1. Pull factors identified in the research included vouchers, discounts and measures to ease access. Additionally, if the product promised to improve the borrowers credit rating, then this too was a strong pull factor. For some borrowers, irrespective of the cost of credit, it is a big draw if they can access the loan quickly. Sometimes these pull factors are also intermingled with social acceptability. If they know someone else using the specific credit product, then to feel part of the crowd is a strong attraction.

6.2. Some users of credit in this research acknowledged that they would spend more on items such as clothes if they were paying with credit. Additionally, somewhat perversely, some viewed the discounts linked to credit offers as the optimal way to 'save' by buying the discounted items. This seemed particularly true during 'sale' periods where offers were commonplace. One participant noticed a £40 voucher offer if she paid using a store card and immediately took one out, having never owned any store cards before.

6.3. Those of a more 'functional' mindset were not generally swayed as much by pull factors: this was more the case for those of an emotional or social mindset. Of all products considered, Retail Credit[12] had the most pull factors in terms of special offers, vouchers and discounts.

6.4. Borrowers were subject to a variety of push factors when it came to taking on new lending. These have been well documented elsewhere but included unemployment, illness, bereavement and the need for white goods if they broke down. Some consumers were pushed into borrowing just to survive, including those on irregular and/or low pay. Within this group some planned their borrowing in advance. They would assume a shortfall at the end of the month and arrange the credit line before the need actually arose. On the one hand this shows planning and proactivity but due to their low financial resilience, many had poor credit ratings and restricted choices, leading them to look for products where they thought there was a good chance that they would be accepted. These products typically had higher than average interest rates.

6.5. Another key push factor mentioned by more than one interviewee was when the interest-free period on a product was about to end and they had no means of clearing the balance. Many in this situation spoke of a desperate scramble to refinance. This shows one of the dangers of entering into credit agreements with an interest free period without a clear plan as to how the balance would be cleared.

7. Accessibility, Affordability and Awareness

7.1. The choice of product was found to be determined by three key factors:

(i) How a**ccessible** the product was,
(ii) The borrower's assessment of **affordability**, and
(iii) **Awareness** of the product.

7.2. Many of those early in their credit journeys want to be able to access products as and when they need, with a minimum of fuss. Statements in adverts like "no credit checks" were a big draw as this was assumed to increase acceptance and speed up the process. Products that can be accessed online are considered favourably because of the speed of access, as well as those with little administration. BNPL products accessed at the checkout were also seen favourably by this group of borrowers.

7.3. Consideration is given to affordability before taking out a credit product, but affordability is judged largely on the basis of whether they can meet contractual payments. Affordability in this context is a consumer's own assessment of their ability to afford the product, not the regulatory requirement on the firm to assess affordability. The consumer sees the latter as more of an assessment of their ability to *access* the product whereas issues of affordability are for them more about how much they can borrow and for how long from the options they can access without the monthly payments getting too high. For the most part, questions concerning the rate of interest rarely surfaced in our research and concerns about APR were even rarer. For example, one respondent argued that she would give up a product if the interest rate became too high but when pressed she could not state the rate of interest which would be her

[12] Storecards and similar products, often retailer branded

tipping point. Although some referenced high interest products that they wouldn't use again, comparisons and choices appeared largely to be non-price related. Some using store cards and other forms of high-cost retail credit felt loyal to their preferred brands.

7.4. There was no consideration given to what would happen if they could not pay off the sum in the future. Some really worry if they are even eligible for the product, particularly if they are further along the journey in credit and have started to hit problems. BNPL products and informal/ unregulated loans were considered more affordable.

7.5. Sometimes consumers undertake superficial online checks to see if a product is worthwhile but in some cases the lack of financial literacy can lead to the wrong decision. For example, they may read an article appearing to recommend a product but may not understand they are not the targeted audience for that recommendation and/or that the recommendation is in fact a financial promotion.

7.6. Positive online reviews and a prominent position in a search engine can be a key consideration. This highlights the dangers of algorithms in search engines which may show certain financial products at the top of the search for certain consumers based on their previous searches and other internet behaviour. Note that the dangers of algorithms combined with advertising has previously been highlighted by the FSCP[13].

7.7. There was a segment of consumers who spend a decent amount of time researching the product, but these tend to be people with a more cautious ('functional') mindset. Some do think about the longer-term implications of a product, including having a long-term plan to pay off the full sum.

8. Financial Literacy, Financial Planning and Budgeting

8.1. The research highlighted an alarming lack of financial understanding. Many participants were unaware of the APR of their credit agreements and only some knew the monthly rate of interest. Others even said that they would borrow money from a loan shark or someone they don't know well despite not understanding the consequences of doing so.

8.2. Most research participants focussed on whether they could meet the monthly payments and used a variety of strategies (not always successfully) to ensure that they did so. Some would set date reminders in their phone calendars, but found this challenging when managing, for example, different BNPL payments on different dates. Some partners would split their financial responsibilities in different ways, for example one partner might pay all the core bills including debt repayments and the other would be responsible for discretionary expenditure.

8.3. Again, actions tended to be guided by short-term considerations, except in the case of those with more of a 'functional' mindset who would consider the longer-term implications and costs of their borrowing.

[13] Financial Services Consumer Panel: Discussion Paper on Digital Advertising in Financial Services

Chapter 3: Identifying risks of harm and potential solutions

The research pulled together a great quantity of information which highlighted potential risks early in the credit journey, which if mitigated could possibly stop borrowers from ending up with problematic debt.

1. Search engines and algorithms

1.1. Those borrowers who tried to do some research online to find suitable products were in many cases steered by search engine algorithms and online marketing. Some mentioned finding the product at the top of the Google search and being impressed by reviews. If someone has in the past borrowed using BNPL or high-cost credit then the algorithms will often show them more of the same. It is unlikely for example to show loans from credit unions or other alternatives. For some types of borrowers - particularly those of a more impulsive or social mindset this unconscious restriction of choice could be quite dangerous.

2. Credit Reference Services

2.1. One borrower mentioned using a Credit Reference Service (CRS) to check his credit score and this tool also showed him lenders that were more likely to be accepted by. Many of these lenders were at the high-cost end of the market and further borrowing could potentially compound this borrower’s problems.

3. Taking out credit to repay another lender

3.1. Borrowers mentioned taking out a credit product to pay another. As part of a longer-term credit strategy where an individual might be aware of an increase in income in the future, this type of activity can play a role in income stabilisation but without a longer-term plan to pay off the balance, this type of behaviour risks over indebtedness.

4. Not recognising debt as debt

4.1. The fact that many in this study did not recognise outstanding credit balances as debt early in the credit journey could lead to over-complacency, until it is too late. We need to help people understand their obligations, and help them plan, without stigmatising all borrowing.

5. Behavioural elements of borrowers

5.1. Borrowers in this study showed a range of emotions when it came to credit choice and debt management. Behaviours such as making an emotional decision to buy a product, seeking products with the lowest amount of friction irrespective of cost, the normalisation of credit, optimism bias and not seeing debt as debt could lead to consumer harm. Risks are particularly heightened when combined with a lack of financial literacy.

6. Potential solutions under development

6.1. There are market and academic led initiatives which are attempting to deal with some of the harms highlighted here. Some lenders are working to develop more screening criteria for lending which takes into account a wider range of information around behaviours and vulnerabilities. It is our understanding that credit scores play a reduced role in many loan decisions.

6.2. A new initiative steered by incuto[14] and Newcastle University[15] could help. They are setting up the Corporate Digital Responsibility code[16]. By setting high standards for the way customer data is used, looking at a wider range of data with permission and taking into account that around half of the population are vulnerable in one way or the other, they aim to use technology to solve lending and customer problems.

6.3. Research undertaken by Bristol University and the UKCards Association[17] suggests a range of tools which could be used by lenders to improve the lending experience for vulnerable consumers. The research highlighted that those with a lack of financial resilience felt forced to take out higher cost credit as they could not borrow at more normal rates. Many of these borrowers have irregular earnings and some are living at the margins. There might be more affordable solutions for these groups for example credit unions and other social lenders. There could be more publicity about such options, using a range of approaches that challenge higher cost options in key channels like social media. The Panel supports the work of Fair For All Finance and others in promoting awareness of affordable credit options and developing the sector's capacity to serve more people.

[14] https://www.incuto.com/team
[15] https://eprints.ncl.ac.uk/file_store/production/275486/B65353E2-A57E-4528-AF55-F64749BEA962.pdf
[16] https://corporatedigitalresponsibility.net/
[17] https://www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1703-vulnerability-guide-for-lending-%28web%29.pdf

Chapter 4: Recommendations

1. Introduction

1.1. This research has identified several potential drivers of harm in early consumer credit journeys. In this section we make a suite of recommendations to address these. In some cases, other work we are aware of points to specific solutions that could be developed. In others, more research will be required to better understand the seriousness and prevalence of the harm we identify before solutions can be designed. Some such work is urgent because unique opportunities exist to make change, which if missed could lead to harm continuing for many years.

1.2. The early consumer credit journey can be very short, giving very little opportunity to intervene to stop consumers making and habituating poor choices. Inexperience reinforces an environment where natural behaviours and attitudes and social and cultural biases can influence decisions and choices more than financial considerations. We believe those in the normalising and surviving typologies are particularly at risk of harm, driven as they are by 'emotional' and 'social' mindsets.

1.3. The research report by Britain Thinks highlights "considerations" arising from the potential drivers of harm identified in their work. These point to specific steps in consumers' credit journey where improvements could be made to deliver better outcomes. These form the basis of the Panel's recommendations.

2. Recommendations

2.1. Supporting people with credit decisions and credit management from their very earliest use of credit.

2.1.1. Our research suggests inexperienced borrowers felt in control of their borrowing, even when making minimum payments. This can and does lead to accumulating balances, prolonged repayment periods and, for some, repayment difficulties in the future[18]. They often did not consider how changes in circumstances might affect their ability to repay. And they thought of debt as a problem other people had got into, and had a desire to follow their social networks.

2.1.2. The question of how to support people in credit decisions before problems crystalise is not new. MaPS and debt advice providers have considered "early" or "pre-arrears" interventions for some time, with mixed success, at least in part because people, as our research shows, do not associate borrowing obligations with problem debt, and hence with the need for help or support.

2.1.3. Lenders and others provide relevant online tools. Searches on a variety of everyday questions like "how can I manage my credit?" "cutting the cost of my loans and cards" "what can I do to keep track of my finances?" and "keeping on top of my borrowing" direct consumers to:

- Resources to help reduce and resolve problem debt
- Offers of consolidation loans or balance transfer deals
- Credit Reference and Scoring services

[18] See for instance this MoneySavingExpert warning

- Household budget planners

2.1.4. These results will be helpful to some consumers, but it suggests a gap for services that:
- Recognise the dissociation in people's minds between borrowing and debt
- Are targeted towards individuals who are using credit, or particular products, in combination for the first time
- Are personalised (allow consumers to look at their real circumstances) and action oriented
- Are independent of any sales or commercial interest

2.1.5. **Recommendation 1**. The Panel would like to see credit management tools developed, capable of aggregating a consumer's borrowing data in one place and enabling forward repayment projections and "what-if" scenarios. This would help people visualise their overall position, view affordability in that context and prioritise repayments if necessary. The market can be encouraged to provide such tools but in line with the thinking behind pensions dashboards, we believe there is a role for a non-commercial, wholly independent, version of such a tool.

2.1.6. Accordingly, **the FCA along with the Money and Pensions Service (MaPS) should develop ideas in the recent Occasional Paper on whether so-called Roboadvice[19] can help people make better repayment decisions**. Immediate next steps could include exploring how Open Banking and credit file data could be combined as inputs to the system to deliver personalised tips and "advice" to help people manage their finances. Of course, there would have to be a clear opt-in path for consumers.

2.1.7. The kind of tool we are suggesting could direct people to take actions that directly reduce the risk and impact of harm, while also building knowledge and confidence, through what-if scenarios, gamification and other techniques that might accelerate people's learning and experience. Research commissioned by the FCA found that experience is more impactful on consumer behaviour than interventions to improve the financial literacy[20].

2.1.8. Next steps could include:
- Further work on the key attitudes and behaviours to understand their prevalence, interactions and impacts to help determine which nudges could help consumers. The common disassociation between outstanding credit balances and debt that our work found among early credit users would be a key area of focus.
- Early work with firms, as part of embedding the Consumer Duty, to test consumer understanding of key aspects that make up the total cost and obligations associated with borrowing, such as capital Vs interest, interest rates and duration.
- A 'Tech Sprint', rapidly bringing together large data sets, coders, designers and user experience expertise, to refine the problem and kick-start solution development.

2.1.9. Participants in our research regarded credit cards and overdrafts as part of an essential financial portfolio, as common and necessary as a bank

[19] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-61.pdf
[20] https://www.fca.org.uk/insight/learning-experience-financial-services

account. There was doubt in some people's minds about whether overdrafts in particular were credit at all, and over whose funds are whose. These products therefore provide additional opportunities to reinforce messages about what genuine control looks like and to mitigate harm that might otherwise arise.

2.1.10. The FCA has published a paper on minimum credit card payments and in 2018 announced its intention to consult on mandating their removal from credit card statements as this 'anchor' could be contributing to persistent debt[21]. It then started to explore whether this would have any unintended consequences but the further work was placed on hold during the pandemic. Subsequently, the FCA decided to wait for the evaluation of the of the credit card market study before proceeding.

2.1.11. As part of the 2018 work the FCA also implemented persistent debt remedies which required firms to take steps to help consumers out of persistent debt. These interventions have helped 600,000 people pay down their debt faster[22] and the FCA has kept them under review[23].

2.1.12. The Panel is aware of, and broadly welcomes, moves by some firms to nudge consumers towards lower cost, less risky, repayment patterns. Instalment plans are increasingly common on credit cards. We are concerned that the re-prioritisation of work during the pandemic is, as the cost-of-living crisis intensifies late in 2022, leaving the regulatory regime with unfinished business.

2.1.13. **Recommendation 2**. **The FCA should review persistent debt rules and conclude earlier work on de-anchoring in view of our new evidence of early credit users' sense that they control in respect of credit cards by meeting minimum payments**.

2.2. Promoting product understanding and informed decisions in the early consumer journey.

2.2.1. The normalisation of credit means that potential borrowers do not scrutinise new borrowing sources against their personal needs and circumstances[24].

2.2.2. The FCA's new Consumer Duty requires firms to deliver 4 outcomes: consumers receive communications they can understand; products and services meet their needs; products and services offer fair value; and consumers get the support they need.

2.2.3. The consumer understanding outcome represents a welcome shift in regulatory focus from disclosure-based requirements (writing down for consumers what they should be told) to understanding. Firms should be required to demonstrate that they have tested their application process

[21] https://www.fca.org.uk/news/news-stories/fca-publishes-outcome-testing-behavioural-remedies-address-under-repayment-credit-card-debt
[22] https://www.fca.org.uk/publication/annual-reports/2021-22.pdf p34
[23] See, for example, Dear CEO letters to lenders in 2020 https://www.fca.org.uk/news/press-releases/fca-tells-credit-card-firms-review-their-approach-persistent-debt-customers
[24] As we indicate at 7,3 above it is the consumer's assessment of their own affordability which we mean here, not firms' requirements to assess.

information and statements with real consumers to ensure clear consumer understanding.

2.2.4. The Government is reviewing the Consumer Credit Act 1974 (CCA). It has stated that the FCA will be given responsibility for much of what the Act covers, and it seems the rationale is that many of the objectives of the Act align with the Consumer Duty. We have yet to see detailed proposals and the Panel has not taken positions on CCA reform, but in principle, the move to a more flexible, outcomes-based approach which genuinely helps consumers understand products and services will be welcome.

2.2.5. **Recommendation 3**. **FCA should research and enforce a better disclosure framework under the Consumer Duty. The FCA should not wait for the CCA Review to conclude before closely supervising the consumer credit market against the new Duty.** This will also be an opportunity to conduct consumer research, at scale, to establish what an improved, understanding-based regime should look like. Key aspects to this work will be:

- A regime that delivers comparability between firms and purchase channels
- A regime that ensures understanding of key aspects of their borrowing such as interest rate and APR, with examples
- A regime that ensures understanding not just the best-case scenarios, but also the impact of late or missed payments.
- A regime that ensures understanding not just at the beginning of the credit journey but throughout at regular intervals.

2.2.6. The Duty also specifically highlights the harm that can arise from journeys that exploit behavioural biases before, at and after the point of sale. Our research suggests inexperienced credit customers are likely to be at risk from this sort of harm.

2.2.7. The research points to the fact that consumers will be better served if behavioural and attitudinal segments were included in the product purchase process. This is likely to be important at the promotion stage. FCA should research the impact of pull factors in credit promotions, and the absence of signposting to affordable credit, and if they find evidence of harm, use the Duty to improve market practice. Such work should include vulnerable consumers as well as a range of behavioural typologies.

2.2.8. In 2021, the Woolard Review highlighted issues around balancing consumer protection and control with innovative, attractive application processes in the burgeoning online lending market[25].

2.2.9. **Recommendation 4**. In light of these competing considerations, and the opportunities presented by the CCA Review and the New Consumer Duty,

[25] Woolard Review 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 research and propose what the key features are of a good consumer journey in terms of balance between ease and friction.**

2.2.10. This should be examined in online and offline settings. Although the literature emphasizes the speed of online credit purchases with little friction, similar could be said about the "lubricating" impact of retail offers including discounts and vouchers at the till. Our research indicates how influential these can be, and their placement can create vulnerability.

2.2.11. One specific area of concern to the Panel is credit-builder products and more widely the way credit files are used as a "hook" to influence credit purchase decisions. Our research showed that where a consumer believes a product will help to build their credit record it can be a powerful pull factor to purchase.

2.2.12. **Recommendation 5. FCA should review consumer understanding of the way credit score improvements are marketed**, and require firms to evidence, in line with the Consumer Duty outcomes around fair value and consumer understanding, the impact on the credit scores of different types of customer in different situations.

2.2.13. Although it was an isolated case in our research, the Panel was concerned about the participant who was recommended a high-cost credit product by a Credit Reference Service in the course of researching their score. FCA has rules around the credit information and broking activities of credit information providers, and we the Panel looks forward to the delayed credit information market study to see if changes are recommended.

2.3. Protecting people from borrowing to repay borrowing

2.3.1. In the literature, taking on credit to repay other borrowing is commonly regarded as a sign of financial difficulty. Sometimes such actions can be useful when part of a long term sustainable financial plan, but they can also run the risk of creating unsustainable repayments.

2.3.2. FCA has acted against harmful repeat borrowing from individual providers, but relies on affordability rules to prevent unsuitable accumulation of credit across different lenders. Our research shows a variety of factors that push and pull consumers to different products at different times. Loan decisioning still varies widely.

2.3.3. The Panel does not have a specific recommendation in this area, beyond the development of tools to help people manage their obligations. We would like to see further research and mining of real borrowing and repayment data to see whether regular re-financing is a forward indicator of financial distress. If supported by evidence, interventions could be considered.

3. Conclusions

3.1. These findings and recommendations are based on qualitative research which gives a rich understanding of credit journeys but it cannot say how many consumers are impacted by the findings of this paper. To do this, more research of a quantitative nature will be needed.

3.2. Our findings make an interesting and somewhat worrying picture of the signs of harm early on in the consumer credit journey. Credit is a necessity for most members of society but it must be offered and administered in ways that are not to the consumer detriment. The impact of poor credit decisions have a high societal cost in terms of mental health, family breakdown, job losses etc and it has to be recognised that by getting this right, there are a multitude of tangible and intangible benefits to society as a whole.