



Select Committee on Financial Exclusion

Corrected oral evidence: Financial Exclusion

Tuesday 1 November 2016

10.40 am

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Members present: Baroness Tyler of Enfield (The Chairman); The Bishop of Birmingham; Lord Empey; Lord Fellowes; Lord Harrison; Lord Haskel; Lord Holmes of Richmond; Baroness Primarolo; Lord Shinkwin.

Evidence Session No. 12

Heard in Public

Questions 122 – 131

Witnesses

I: Damon Gibbons, Director, Centre for Responsible Credit; Sue Lewis, Chair, Financial Services Consumer Panel.

USE OF THE TRANSCRIPT

1. This is a corrected transcript of evidence taken in public and webcast on www.parliamentlive.tv.

Examination of witnesses

Damon Gibbons and Sue Lewis.

The Chairman: Welcome to this evidence session of the Select Committee on Financial Exclusion. You have in front of you a list of interests that have been declared by members of the Committee. The meeting is being broadcast live via the parliamentary website. A transcript of the meeting will be taken and published on the Committee website. You will of course have the opportunity to make any necessary corrections to the transcript. Would you like to introduce yourselves, please—who you are and the organisation that you represent?

Damon Gibbons: I am Damon Gibbons. I am the director of the Centre for Responsible Credit, which is an independent, not-for-profit think tank and research unit in the Learning and Work Institute. We are hosted by that charity.

Sue Lewis: I am Sue Lewis. I represent the Financial Services Consumer Panel. I am also a trustee of StepChange, which may be relevant to these discussions.

Q122 **The Chairman:** Thank you. We have quite a lot to get through, so I will kick off with the first question. How do you think the pattern of consumer credit and problem debt has changed since 2008, and what are the consequences of those changes?

Damon Gibbons: We considered that recently in a report that we put out for the TUC—*Britain in the Red*—which looked at the pattern by volume of lending that is taking place. After 2008, there was an immediate dip. Households cut back on consumption, which was, of course, part of the reason for the recession around that time. They also paid down debts, so there was a fall in the outstanding amount of consumer credit. Since 2010 in particular there has again been a significant increase in consumer credit indebtedness. On the aggregate figures from the ONS, we are probably only about 5% away from the peak in 2008. In total, over the last eight years, the aggregate level of consumer indebtedness has fallen by only about 5%, which is very limited.

There has been a shift towards credit card lending. In 2008, around 33%—a third of the market—was credit card debt; it is now around 41% or 42%. That has been a significant shift. On some of the specific lending products, we have seen the expansion of subprime credit cards, particularly very high-cost products such as those offered by Vanquis Bank, which is part of the Provident Financial Group. There have also been changes as a result of regulatory action by the FCA, particularly the cap on payday lenders, which morphed that product into a sort of instalment loan. That has some benefits and some disadvantages for households using such products.

There has been renewed growth over the last year or so in home credit—the door-to-door loans that are offered by the likes of Provident Financial and others. There is greater concern about alternative credit products such as guarantor loans and logbook loans, which have come under great scrutiny. We have had long-standing growth in the rent-to-own market—BrightHouse and so forth.

As far as I can see, the overall driver for that is that as the stock of consumer credit has not reduced significantly, interest payments on consumer credit debt are still at a very high rate. Interest rates on consumer credit debt have not fallen, despite base rate cuts. The squeeze on incomes, particularly with the lack of real-wage growth since 2010, has meant that consumer credit debt repayments are a greater burden on households than they were before. That is probably some of the explanation behind why debt advice charities are reporting increased arrears on household bills, for example. It is not necessarily because, as some in the high-cost credit sector might argue, credit options have been constrained, and people are therefore not able to manage their cash flow and are getting into arrears with household bills. Quite conversely, credit growth is strong, but interest payments relative to the surplus of people's disposable income are much lower. That is causing that effect.

Sue Lewis: There is not much I can add to that comprehensive description, except that since the FCA took over regulation of the consumer credit market we have seen a lot of gaming of the system. For example, since it imposed the payday lending rules, we have seen products that are more in the nature of rolling credit. As Damon said, there has been a rise of alternative products such as guarantor loans.

The Chairman: I have one quick follow-up question; you touched on it, Damon, in that comprehensive overview. We have had quite a lot of evidence that the make-up of problem debt has changed in nature quite a bit over the past 10 years. Whereas 10 years ago it would primarily have been debt from credit cards, catalogues and that sort of thing, that has now been overtaken by areas such as council tax, rent and utilities arrears. Do you share that view?

Damon Gibbons: I certainly do not dispute the fact that debt advice agencies, at least not-for-profit debt advice agencies, report more people coming to them with those kinds of debts. That is indisputable. However, that is not the entire picture of the indebted population. There are probably some shortcomings in relation to the data that we have about the types of debt problems that people have.

There has been a burgeoning in for-cost—for-profit—debt advice by companies. We do not have good insight into the types of problems that they are reporting. I suspect that for-profit debt management plan providers are more interested in trying to get hold of debtors who have consumer credit debts rather than household bill debts; they make money from debt management plans on consumer credit debts rather than household bills. We do not have a comprehensive picture.

From the aggregate data, the Office for National Statistics produces other accounts payable in the national accounts, which is non-consumer credit debt, and could comprise council tax, income tax, debts to small businesses and various other things. That is bundled together in the aggregate data in the national accounts. Until the ONS releases a breakdown of other accounts payable in that dataset, we will not know for sure, but the amount owing in other accounts payable has been falling, not increasing, in recent years. It is for the ONS to come back and provide further detail on that.

Sue Lewis: That is certainly something we observe, if I can pop my StepChange hat on for a minute. The other thing I should have mentioned is that we are seeing a big increase in friends and family borrowing, with an average of something like £4,000 outstanding to friends and family, which can put strain on those relationships.

Q123 **Lord Haskel:** There are a variety of ways to resolve problem debt: individual voluntary arrangements, debt relief orders, bankruptcy and others. Do they add to financial exclusion, or do they help to avoid financial exclusion? Which is it?

Damon Gibbons: It is a bit of both. In the UK, the landscape of insolvency, and indeed debt management, for want of a better, broader, term—in which I include debt advice and debt management plans—is extraordinarily confusing and fragmented. Each solution—IVA, a debt relief order, bankruptcy or a debt management plan—has pros and cons. It is extremely confusing for debtors to know which is the most appropriate procedure for them. The biggest problem is that it is not fit for purpose as a landscape.

As I have already recounted, the pressures on households of indebtedness and the payments they are making on consumer credit have increased significantly since 2010, but the number of people going through insolvency procedures has fallen. There was a slight uptick in the last quarter's figures, but generally there has been a significant reduction in the number of people going through insolvency, which means that they are not getting access to a write-off. Where there have been increases, they have been in the number of people going into debt management plans, where there is no write-off of debt and they are very lengthy. One purpose of an insolvency regime is to release people from their debts, given certain conditions, and to make them productive members of society again as quickly as possible. We do not seem to have a landscape of provision that actually does that.

There are certain specific things that we could learn from other countries; for example, chapter 11 in the US, which protects debtors' homes. We have a problem for people in mortgage difficulties with consumer debts, who will not take bankruptcy or who will end up paying huge amounts of fees in an IVA if they go down that route, and for whom a debt management plan with no write-off is effectively their only option. There are some other idiosyncrasies. Debt relief orders have an upper limit on the amount of debt that you can have in order to qualify. That seems

strange, in that those who are most indebted with no assets will not get assistance through that procedure. You have to be below that to get assistance.

The fundamental point is that a lot of debt has been written off by originating lenders in the system and sold. It has been bought up by third-party debt collection companies, which are now backed by private equity. They have expanded dramatically. They bought up those debts at 5p or 6p in the pound, yet the debt is being collected at full rate. A lot of that debt is on debt management plans and is still being paid for at 100% of the nominal face value. A lot of debt could be written off, but it is not. In economic terms, that is quite significant: interest payments on consumer credit debt of around £26 billion a year, which is a significant amount—over 1% of GDP—are going on debt repayments, a great proportion of which, I imagine, has already been written off on bank balance sheets.

On the financial exclusion point, these are lengthy procedures if you are in a debt management plan for eight years. How does it help you to become included again if your IVA is for six years? Those are the sorts of issues. It should be a question of obtaining quick release for people who have no prospect of repayment, but it is not.

Lord Haskel: The speed of resolving the problem is important.

Damon Gibbons: I think so, yes.

Sue Lewis: The whole landscape is really confusing for consumers. Often they reach some sort of solution through a lead generator—someone spams them and says, “We can solve your problems”, and they may not end up with the best solution for them. They may go to one of the reputable agencies, but they may not. I would like to see something that reduces that confusion and perhaps regulates the lead generators. People are very vulnerable at such times.

On the point about the lengthy process, the one thing about debt management plans and the like is that they can help people to rebuild a credit record—even though that takes quite a long time—because they can show their ability to repay debt. I fully accept, however, that the timescales are very long.

Q124 **Lord Empey:** In an era of devolution, the regions now have legislative responsibility for this area, in many cases. Could any lessons be learned about different practices in different parts of the country?

Damon Gibbons: The debt arrangement scheme in Scotland is the obvious place to look. It is an improvement, although it does not have write-off within it either. I would like to see something in the UK that is systematic, such as the debt arrangement scheme in Scotland.

Lord Empey: Could I interrupt you? Are you aware of the breathing space Bill in the other place, from Kelly Tolhurst? It sounds a bit like chapter 11 to me. Is there any traction in that, do you think?

Damon Gibbons: There certainly would be if we were to have in the UK the breathing space proposals that StepChange put forward. I fully support those. It will be interesting to see what is happening with regard to that in the devolved Administrations, in Scotland in particular. They have not necessarily made full use of the powers they have; for example, I would have thought that some element of write-off in the debt arrangement scheme would be a major step forward. Devolution provides a testing ground, hopefully, for variations on a theme.

Sue Lewis: The breathing space proposal is the best example, I agree.

Q125 **Lord Harrison:** Sue, you are a member of the Financial Services Consumer Panel, which has called for a “duty of care” to be placed on financial service companies. Could you tease out for us what form that would take? More especially, how would it affect the financially excluded?

Sue Lewis: It has certainly been one of our themes for a while. We are proposing a duty of care in primary legislation that the FCA would then interpret in its rules, depending on the complexity of the market that was under consideration. In practice, it would mean that firms would be required to avoid conflicts of interest and put the interests of their customers first. That is not a fiduciary duty, because obviously they also have duties to shareholders, but it would mean that their business models would need to act in the best interests of consumers. PPI is an obvious mis-selling problem that would not have happened if banks had had a duty of care, because they would have had to check that the elements of PPI were suitable for the customer they were selling to. They would put the interests of that customer first.

Lord Harrison: Why is that not a fiduciary duty? Properly interpreted, a fiduciary duty is to improve opportunities for the firm, by having concerns environmentally and for the workplace, and for the consumer. I see that duty of care as a fiduciary duty.

Sue Lewis: We have not described it in that way. In one sense, it does not really matter. What matters is what it could achieve in legislation just in clarity, both for consumers and for firms in knowing where they stand. At the moment, they have the FCA’s slightly vague principles of treating customers fairly, but those principles are not rules, and it is therefore very hard for the FCA to enforce against them, and for the ombudsman service to take them into account when it determines compensation. It is about clarity across the board. If someone is not actually a customer, how does the duty help them? It would not directly, but it would enable or force banks and others to look more broadly at what they offer. One of the exclusion problems is that there are no products that respond to the needs of those on lower incomes.

Lord Harrison: Damon, could you tackle that aspect? How, in the end, does it help those who are financially excluded, if indeed you agree with the idea of a duty of care?

Damon Gibbons: I will not go into detail about the specific proposal. Some years ago, when the Financial Services Bill was going through Parliament, we responded to it by arguing that there ought to be broad social and economic objectives for banks in particular, and some obligations ought to be placed on them in return for what is an implicit taxpayer guarantee, a bailout and so forth. We would like that expressed in a way that is similar to the Community Reinvestment Act obligations on banks in the United States, where there is an affirmative obligation for banks to demonstrate how they meet the needs of underserved communities. They do that by setting out their plans to meet the needs of lower-income communities and by being ranked on that by the regulator. As a result, trillions of dollars have flowed from banks through credit unions and other local economic development in the United States. We see that sort of obligation as something that should be pursued in the UK, too.

Short of that, however, we tried for obligations with regard to disclosure of lending patterns at local level, so that there could be a process of better engagement between local communities, local authorities and other stakeholders and the banks, saying, "What are you doing in our community to support our businesses and help households in financial difficulty?" and so forth. It is very disappointing that although Parliament discussed that at length as a potential amendment to the Bill a few years ago, government chose to take it down a voluntary route with the British Bankers' Association.

There is a voluntary disclosure framework in place. Banks have been disclosing lending patterns on personal loans at postcode level for a number of years. We looked at that recently. We did a case study in Leicester, and overlaid the data with other locally available data. Only 15%, or thereabouts, of the consumer credit market is covered by the disclosure framework. We do not have credit card lending, we do not have overdraft lending and we do not have any of the higher-cost lenders involved in that disclosure framework. It is not really doing the job of driving the necessary engagement about where the problems are and which lenders in particular need to engage with local agencies.

Looking again at obligations with regard to disclosing what lenders are actually doing in local areas would be very useful. I accept, however, that it would not address Sue's point, which is whether it would stop PPI or those sorts of problems. That is a different kind of duty. We are getting into discussions about whether principles-based regulations such as those pursued by various regulators over the years in the UK have been effective or not, or whether more stringent rules regarding products and other regulatory interventions are required.

Q126 Lord Holmes of Richmond: Where has the Financial Conduct Authority been successful in its activities so far, and where might it do better? How well do you think the authority has dealt with the subprime lending sector, not least payday loans, rent to own and home credit?

Sue Lewis: It has certainly acted swiftly on high-cost, short-term credit. That was fine. It is still thinking about adjacent markets such as rent to own. Our biggest point on this is that most debt is credit card debt or overdraft debt. Payday loans hurt very vulnerable people, so it was absolutely right that the regulator dealt with them, but most of the overindebtedness we see is due to credit cards and overdrafts, particularly unarranged overdrafts. We want a level playing field on regulation across all forms of debt. If that means a price cap, it means a price cap on the cost. Unarranged overdrafts are often more expensive than payday loans, but they are completely unregulated. We want that market levelled.

Damon Gibbons: I agree entirely with Sue's assessment. I am a little concerned as to how far we can thank the FCA itself for the interventions in the payday lending market. The original Act that set up the FCA gave it the power to cap prices, a power that it chose not to use. Effectively, Parliament forced the FCA to cap prices in respect of payday lending. The FCA itself was very reluctant to use those kinds of direct interventionist approaches. Indeed, it is concerning that its mission statement, which it put out for consultation just last week, focuses on the primacy of using competition interventions, rather than consumer protection interventions. That is worrying, because over the years there has been very little evidence that competition-type initiatives, for example, to promote switching among lower-income consumers and so forth have actually worked. That dates back to 2005 and the Competition Commission's inquiry into home credit, in which I was heavily involved at the time.

Of the so-called remedies that the Competition Commission brought in and that it evaluated itself only a few years ago, it said, "We cannot tell whether or not the competition aspects of what we have tried to do have had any effect at all on the market". What it could say was that the requirement to give a rebate to people who effectively re-rolled over their borrowing in that area of the market had had an impact. It knew what direct intervention had cost the industry, and how much of that had transferred to households, but it had no idea whether the competition stuff that it brought in had had an impact.

We saw a similar case recently when the Competition and Markets Authority looked at switching for people on unauthorised overdraft charges. It is very difficult for people who are in debt to switch, because they are effectively trapped by the requirement to repay the debt before they can move. I do not think that competition approaches in that sector of the market will be effective. It is very worrying that, since 2008, regulators in the UK have not looked afresh at the evidence as to whether competition-type approaches deliver good outcomes for lower-income consumers. It is more an assertion and an article of faith by regulators in the UK that those approaches will work.

The good stuff that I think they have done is on supervision and enforcement, where they have uncovered quite a lot and put in place redress schemes; for example, with Wonga and other payday lending

companies. I have some concerns with regard to the consistency of those redress schemes. It is not easy to work out why in some circumstances the FCA says that all the loan will be written off, yet in other circumstances it says that the detriment is such that only the interest will be written off but the household still has to pay back the principal. That is inconsistent with the Financial Ombudsman Service approach in a number of cases. It is extremely confusing.

It is extremely surprising to me that home credit was left out, and specifically excluded from the high-cost, short-term credit cap. I do not know the reason for that. The problems with home credit in this country have been long standing. The Competition Commission failed to sort that out, the OFT failed to sort it out and now the FCA is failing to sort it out, too.

On affordability, we have a real dog's dinner. I do not think that the industry is very clear about what the affordability rules mean, and I do not think that consumers or consumer agencies are very clear about what it is all about. I hope we get to something much more structural. As an example, we talk about lots of problems in the credit market, and we could say that student loans are a problem, but one of the good things about student loans is that it is pretty clear that if your income is below a certain amount, you do not pay the loan back. There is acceptance of that. It is pretty clear to students and it is pretty clear to lenders. Why we do not have as straightforward an approach regarding consumer credit, I do not know. That is the approach they have in a number of US states, and in Canada, too. We have not really seen the FCA fundamentally depart from the pre-2008 approach and the OFT approach, but it has been pushed in a number of areas to take action where it was otherwise reluctant to do so.

Lord Holmes of Richmond: I will ask this briefly, and I ask for a brief answer if you are able. The inconsistency point that you raise is incredibly important. What is your sense of the reason for that inconsistency? What needs to be done to get an assurance that when action is taken it is consistent across the piece?

Damon Gibbons: The reason for it is simply that the FCA has not set out the basics of its thinking when it has put in place redress schemes. It has almost been, "Let us announce a redress scheme", and that is sufficient to keep people happy with the fact that it is doing something. I do not think that it has thought through the principles behind which those redress schemes would be calculated and put in place.

There is an element of pragmatism about the FCA. I do not know whether it wants to set out in detail the basis on which it will work through what a redress scheme looks like for public scrutiny, to see whether it meets the public opinion test of whether it looks fair, or whether it wants to cook up a redress scheme that is sort of acceptable to the firm and will not put it out of business, and makes it look as if the FCA is taking action. Simply because of the lack of transparency, I do not know what the truth is behind that, but I know that it does not look good.

Lord Haskel: You spoke about most debt being unauthorised overdraft and on credit cards. Do you think that the banks and the credit card companies can do more to stop people going overdrawn unauthorised?

Sue Lewis: Yes, if they wanted to, of course they could. They have the technology to do it.

Lord Haskel: Exactly.

Sue Lewis: They market accounts that say, "For £10 a month we will not let you go overdrawn", the technology is there, but the problem is that that is where banks make a lot of their money. One thing we have called for is a total limit on people's unsecured borrowing, from whatever source. The FCA published a paper in August showing that the biggest predictor of problem debt is an individual's debt-to-income ratio. You could very simply—if the FCA or the industry chose—limit people's borrowing, not necessarily to something affordable day by day, but to a particular debt-to-income ratio. Of course, the industry could do something about it, but it will not while it is making so much money out of people slipping into overdraft or taking on credit debt, perhaps tempted by 0% balance transfers. The credit card industry knows that it is pulling in people who will end up paying a lot more later. Those business practices in the industry cause a lot of the problems.

Lord Empey: On the business of unauthorised overdraft, is the dilemma not that, if a standing order is bounced because there is no overdraft, it can sometimes produce charges of its own? We are just shifting the problem around from one place to another.

Sue Lewis: Under the voluntary agreement on basic bank accounts, there is no charge on bounced standing orders. That is part of the agreement, so, again, we know that banks can do that. They could defer the standing order; they could give the customer the option of deferring a standing order until they have money in the bank.

Lord Empey: Previous witnesses told us about the difficulties. With zero-hours contracts, people's earnings are inconsistent, and if you are rigidly stuck on a standing order cycle for household bills and so on, you can get huge knock-on effects from the providers of those services, even if it is not the banks themselves.

Sue Lewis: Yes, that is true, but I still maintain that there is the technology to enable people, especially those with lumpy incomes, to defer payments until they have some money in.

Damon Gibbons: That is fundamental. A lot of credit is used for cash flow management, because people are in difficulties with fluctuating incomes, fluctuations in expenditure pressures and so forth. If it was easy for them to contact their utility providers, the council or other household bills and reschedule those payments rather than take out credit, they would not pay the interest that they pay, often at very high cost, to high-

cost lenders, and would not necessarily incur other costs, for bounced direct debits or those sorts of things.

It is interesting that we have not seen investment in financial services technology or investment in the energy, the effort and the research to make the sorts of things happen that people would clearly benefit from, but which would not be profit-making for banks or credit institutions. Instead, we have seen development of products that are fast and get money to people quickly when they are having cash-flow issues—those sorts of marketing approaches. Something is going fundamentally wrong in what we are using the available technology for and how we get it to help low-income households, rather than simply creating more credit products on the basis that that is what people will continue to need.

Q127 Lord Fellowes: As you realise, we have received a range of views on the effects of the 2013 regulations on the short-term credit sector. Some have suggested that displaced customers are going to illegal lenders instead; some that they are moving to other legal but less heavily regulated parts of the sector; and some that customers are simply doing without credit altogether. I wondered what your take was on that.

Damon Gibbons: All those things are entirely plausible when the FCA introduces a cap in only one element of the market. That is certainly the case. We used to have arguments about where the cap should be—the level and associated issues. We needed to make sure that lenders who were capped could not evade it, and those sorts of issues. Clearly, if you introduce it in only one area of the market, you allow all the other lenders, effectively, to evade the regulation, so it is not a surprise if there is movement into those areas. There is probably a bigger issue of principle about caps that regulators have not quite grasped, which is that they reduce the level of risk being taken in the financial system as a whole. There are good economic benefits from capping consumer credit more broadly. If returns on investment on consumer credit can be consistently higher than, for example, those on investment in productive business or manufacturing or other things, that is where a lot of the investment will get channelled. It will be channelled into lending to the household sector. Caps have a broader application than simply consumer protection at the individual level. I would like to see a regulator that got to grips with some of the economic arguments for things.

It is entirely possible that illegal lending has taken place. It is not quite as straightforward as some would make out. The payday lending industry, before the cap was imposed, was at pains to point out that the majority of its customers were young, savvy, technologically adept people who were just hard up now and again. They are not the sorts of people who would go down to the local pub and borrow from the local loan shark if they could not get an online loan within 15 minutes. I do not think there is a direct correlation between the types of people who get into lots of problems with loan sharks and the payday lending customer base, where the cap has actually had an effect.

The statistics on illegal lending are not particularly reliable. As with any crime, there are reporting issues. Often, people are more likely to be caught after the illegal moneylending unit has undertaken marketing activities and so forth. We do not know whether that is an increase in the actual number of people who are getting involved with loan sharks or just increased detection and reporting of it. Nevertheless, if you wanted to do something about illegal lending, we should probably have a straightforward criminal sanction for it. The lesson from Japan, when they introduced interest rate caps because of concerns about illegal lending, was that they hiked up the criminal sanction and made it a priority for the police force to do something about it. The result of the cap was a reduction both in the price of credit for people in Japan and in the number of illegal lenders. It can be tackled through those sorts of approaches. Ultimately, however, we need across-the-board, consistent regulation of the different areas of the market.

Lord Fellows: Would you do something now on the regulatory front—right away?

Damon Gibbons: Yes. I would immediately look to expand the scope of the cap to other areas, particularly home credit and rent to own, which have been mentioned, and to credit card lending where it is rolled over on a regular basis to prevent that.

Sue Lewis: The FCA does a lot to warn people about investment scams, but very little to warn people about loan sharking. Both those things are outside the regulated boundary by definition. We would like to see more campaigns on loan sharking. It is important to remember that people often do not know whether the lender they are dealing with is a loan shark or just a home credit person. They both appear the same. It is quite hard to get under illegal lending and the extent that it is carried on. I think the FCA, in its review of the price cap, will attempt to do that, but it is quite a hard thing to do. We would like more awareness campaigns.

Q128 **Baroness Primarolo:** I want to be clear about what you are saying with regard to regulation. Are you suggesting that there is merit in imposing regulatory measures similar to those imposed on payday loans across the subprime credit market? It is not a solution in itself, but it begins to open up the other arguments. Is that the case? What are the other arguments that would flow from that, briefly?

Damon Gibbons: I am suggesting that that is done, yes. The bottom line is that if only one area of the market is capped, as is currently the case, that lends itself to others marketing themselves and taking advantage of the section of the customer base that is no longer being served. Things such as rent to own in particular have expanded in recent years, and they are extraordinarily expensive ways to borrow. I would like the FCA to look at a consistent approach about a reasonable price to pay for credit in the market as a whole, not just in respect of whether the loan is only available for less than 12 months or not—those sorts of things.

Baroness Primarolo: You are suggesting that dealing with the illegal lenders—the loan sharks—would need to be linked to enhancing police activity on criminal measures as well, so that we did not see a shift. Those people will still need the money.

Damon Gibbons: There are two things. First, we ought to take loan sharking very seriously. There should be a specific criminal offence of loan sharking. At the moment, it is very difficult to bring prosecutions under the various pieces of legislation or to get convictions at a certain degree of sentence.

In Japan, the lesson was to have a specific criminal offence of lending without a licence, which was significantly up the scale of sentencing. As a result, the police took it much more seriously in their allocation of resources in local communities. That was one of the lessons from Japan. That in itself will still not be the answer. Fundamentally, we are still talking about people having credit needs, or at least having needs to fund themselves in emergencies or to buy essential household items, and those sorts of things. There is a question about whether the market can deliver for everybody, or whether some of the social policy interventions are necessary to help people in those positions.

The Chairman: Damon, you mentioned various regulatory approaches and legislative requirements in other countries. You mentioned the US, Canada and Japan. Would it be possible for you to let the Committee have a note on those approaches and any evidence that exists of how effective they have been?

Damon Gibbons: I would be delighted.

Baroness Primarolo: Particularly on the point about obligations, so that we do not have a confusing set of messages—key obligations about ensuring that there is accountability, affordability and transparency.

Q129 **Bishop of Birmingham:** Damon, your last comment is a good lead-in to looking a bit more at the effect of the market. You have already mentioned affordability a couple of times. Could you go over that again? How much can we expect of the market in providing short-term, small amounts of lending? On short-term credit, even for that which might be provided by responsible lenders, are there alternative ways of providing credit to people who might not fit into a market model?

Damon Gibbons: It is sometimes helpful to look at things in extremis. If we saw homeless people on the street being lent money at vast interest rates, we would say that it was potentially justifiable on the grounds that not many of those people would pay back those loans, so the risk element is clear. A lender could justify charging them a fortune on a pure market perspective, but it would do nobody any good, and the few who did pay back would be paying for all the other people who did not. That is one of the reasons why the cost would be so high. That is the argument in complete extremis. At some point towards that, a line has to be drawn. Drawing that line is the job of politicians, regulators and so forth, but a

line has to be drawn, because the extreme market position is clearly absurd.

There are two problems. The first is that we have gone down the route of saying, "Let us create more affordable credit, through credit unions and so forth". The difficulty with that is that they too are dealing with people who are fairly high risk, and the scale at which they are able to conduct their operations is limited. We are asking them to create an entirely new, small-scale infrastructure to deliver credit to quite high-risk individuals, and that is very difficult, or virtually impossible, to do. We need some mechanism, or at least a scalable approach, for getting credit to people, and potentially some element of cross-subsidy. In many areas of the credit market, the poor cross-subsidise the wealthier. It is an extremely regressive system, which is driving wealth inequalities in this country.

We have to look at developing social products whereby there is an element of cross-subsidy from wealthier individuals to poorer ones. The classic one would be if people were to pay for their bank accounts and there were not so many back-end charges for people who get into difficulty. The market cannot deliver that, because at the moment everybody is stuck in a prisoner's dilemma: you can never be the first bank to get rid of free banking. There has to be a regulatory intervention to break that prisoner's dilemma.

A couple of things flow from that. First, on the affordable credit side, how do we get that to scale? It would be very helpful if credit unions could pool resources, so that they could mutually and jointly invest in marketing on a national level in the development of products with fintech companies, which would enable them to deliver their services much more cheaply. They are trapped at the moment, because they each individually have responsibilities to their members for their deposits, so how can they take a joint risk on the venture? We need to think about what a back-office pooled deposit looks like for credit unions. In the US, there are credit unions at that level, which operate for the credit union movement and bring those things together. We do not have that in the UK. A national credit union infrastructure would be a good way forward.

There are some good alternatives, such as Fair for You, which is a not-for-profit alternative to rent to own. We need patient capital. The problem with the development of affordable credit in this country has been that lots of capital was given for pilot projects and so forth, expecting them to become self-sufficient within three to five years. It is the opposite in the commercial world, where venture capital is put out for very long periods of patient time. It is expected that the recipients get to scale and then start paying back, not that they start paying back on the route to scale.

The Chairman: Damon, we are starting to run out of time.

Damon Gibbons: Yes, I do not blame you for stopping me. There is a lot.

Sue Lewis: The cross-subsidy has to come from somewhere. It can come either from other customers of the lender or from the taxpayer. Personally, I was a fan of Social Fund budgeting loans, which filled a gap that could not be filled commercially. It has to come from somewhere.

- Q130 **Lord Shinkwin:** I am mindful of the time, so I wonder if you could give brief answers and perhaps elaborate in writing afterwards. Damon, you touched on credit unions. Sue, you opened your remarks by talking about how the crackdown on payday loans resulted not just in alternative products springing up but in a big increase in friends and family borrowing. Given that recent research, for example by Affinity Sutton housing association, showed that some 38% of its residents were unaware of the work of credit unions, how successful do you think third-sector credit providers such as credit unions have been in supporting subprime borrowers who cannot be served in other ways? How could they better be promoted and supported, and what role would you like to see central government taking? I emphasise the time constraints. Could you keep your answers brief and then follow up with further information? Thank you.

Damon Gibbons: We need a national infrastructure for credit union development. In many respects, they have been set up to fail. There have been some good developments recently, however, particularly the Circle Housing and Leeds City Credit Union tie-up, which means that any tenant of Circle Housing, no matter where they live, can join Leeds City Credit Union. The extension of those sorts of common bonds to all housing association tenants has been really good. That is probably the way forward.

The reality is that credit unions were set up as localised takers of small deposits, intermediated into small loans at low interest rates, which is a recipe for very slow growth. It is the model of banking from the 1910s but at an extremely small level. Some sort of element of pooling of loans and securitisation of credit union loans—mechanisms for them to raise much more investment—would be very useful. They have a problem on the marketing side, predominantly because they cannot market nationally as they are all local credit unions. We need a national credit union marketing company.

Sue Lewis: At local level they are absolutely great, but I do not think it is a scalable model.

The Chairman: If you want to add another sentence or two, that is fine. We have time.

Sue Lewis: No, that is okay.

- Q131 **The Chairman:** That is fine. It is an area we have been keen to pursue in this evidence session and previous ones, and I am sure we shall pursue it in the future, too.

To bring this session towards a close, could you tell us where you think the Committee should be focusing its attention? If there were one, or a

maximum of two, recommendations that you would like the Committee to get involved in, what would they be?

Damon Gibbons: It would be a focus on mainstream banks and their obligations to society as a result of the implicit taxpayer guarantee, the bailout and so forth. We need to get back to what banking is for, which is supposedly to support our economy and our households in a positive way. Over the last 40 years, banks have selected a better-off customer group to focus on and have wanted to outsource the provision of services to lower-income households, which is what they have done; they have been investors in high-cost credit. They have supported the development of high-cost credit, but they have not been willing to provide retail services to lower-income households themselves. We need to look at what their obligations actually are and try to find some levers to encourage them to re-engage with the communities across Britain that have thus far been neglected by them. That would be a particular area.

The other area where I would like some ground to be made would be trying to reduce the demand for credit among lower-income households and trying to find ways to harness the innovation and technical know-how of the financial services sector in ways that deliver services such that low-income households do not need to use credit or financial services so much. That means bringing fintech companies and communities together, to co-design products from the perspective of lower-income households, with funding behind that through patient capital, and tests for that and so forth. That is not something the market will ever do itself.

Sue Lewis: The Committee could usefully look at the governance of financial inclusion. The Financial Inclusion Commission's report bore an uncanny resemblance to that of PAT 14, 15 years earlier. My question is: who is making this happen? Personally I think it should be the Treasury. It was the Treasury for a while, and I think it should be the Treasury again. It would hate that.

We have not mentioned another thing you might look at—people who have forcible bank account closures, who have their accounts closed for no reason, suspected of money laundering. Obviously I would like you to look at the duty of care, but I would say that. Finally—Damon touched on this—there are the risks and opportunities of technology and fintechs. It is a risk and an opportunity. We need to look at the future.

The Chairman: Thank you very much. You raised a point about overall governance, and the role of Government in this area is an issue that the Committee has been looking at right the way through its deliberations. We will continue to do so.

It has been a really helpful session, so thank you very much indeed. We have tried to cover a wide area. If you have any subsequent thoughts about things you would have liked to say to us, please feel free to submit a note. Thank you very much for your time.