



Select Committee on Financial Exclusion

Corrected oral evidence: Financial Exclusion

Tuesday 1 November 2016

11.40 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. 13

Heard in Public

Questions 132 - 141

Witnesses

I: Russell Hamblin-Boone, Chief Executive, Consumer Finance Association, Hamish Paton, Chief Executive, BrightHouse and David Rees, Chairman, Law Committee, Consumer Credit Association.

USE OF THE TRANSCRIPT

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

Examination of witnesses

Russell Hamblin-Boone, Hamish Paton and David Rees.

Q132 **The Chairman:** Good morning. I thank all three of our witnesses for coming in today. 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 have the opportunity to make any necessary corrections to the transcript. We have quite a lot of business to get through and there are three of you. If questions are asked and there is nothing you particularly want to say, please do not feel obliged to say something in response to all the questions.

What is your sense of the nature of the customer base? Who is using your products? Written evidence that the Committee has received reports an increase in problem debt and certainly that, in recent years, many borrowers have had difficulties with repayment. I would be interested to know if that has happened in your sector, too. What sort of information do you have about what your loans are used for? Would you like to introduce yourselves, please, as you answer?

Russell Hamblin-Boone: I am Russell Hamblin-Boone, chief executive of the Consumer Finance Association, representing short to medium-term lenders, operating both online and through high street stores.

The first point was about customers and the customer demographic as we understand it. There has been a shift up the income bracket as a result of regulation specifically but, in parts, price as well. There has always been some misunderstanding about the customer demographic that uses short-term loans, particularly as the market has moved increasingly online. The split now is that about 80% of the market is online and 20% is through stores.

The customer income bracket is similar to the average income. The average customer of the member businesses that I represent is earning £25,500, compared with the UK average income of about £26,000. The customers are more likely to be working full time than the population as a whole. They are predominantly aged between 18 and 34 years old; they are 60% of the market. They come from all walks of life, from people in senior positions in industry through to people on zero-hours contracts doing catering and cleaning work—the full spectrum of people.

On what has happened to the market as a result of regulation, price control regulation came into place in April 2014, and price control took effect on 1 January 2015. Before that, 240 firms were registered as offering high-cost, short-term credit. There are no specifics; you have to do a manual trawl of the financial services register. We estimate that there are now about 60 firms, so there has been a significant reduction in the number of firms authorised. There has been a reduction in the number of loans that are issued. Back in 2012, it was about 10 million

loans; there are now 1.8 million loans per year. That is based on 2015 figures, so there will be a slight variation. Overall, lending in high-cost short-term credit, offering a payday loan, has reduced by about 70%. The market has shifted from a payday single-payment loan, which has all but disappeared, to an instalment loan product of three, six, nine or 12 months. That is still captured by the high-cost short-term credit regulatory framework and the price control. The cost of loans has fallen on average as well, by about £30. We provided some data to the Social Market Foundation so that it could analyse the market. Later this month, it will produce its report, which will give a lot more detail. Perhaps it will be useful for the Committee to have that. I will ask the foundation to ensure that you have a copy.

The Chairman: That would be extremely helpful. Thank you.

Hamish Paton: First, thank you for giving me the opportunity to talk to you this morning. Financial exclusion is an important subject for me personally and for BrightHouse as a business. I will start by telling you a bit about what we do at BrightHouse. We are the UK's leading rent-to-own business. I want to give you a sense of what that means, because it is different from some of the financial products that are talked about in this space. If a low-income family needs a new washing machine, and they are not fortunate enough to have a pot of savings to pay for the product outright in cash, and if they have been turned down for credit, be that for a loan or for some form of store credit, for example, they might well consider BrightHouse. The family would consider us because we are welcoming, affordable and supportive of our customers. We give our customers the opportunity to get things that they might not be able to get from other people—normal, everyday things.

To answer your specific question about customers, estimates in this market vary significantly, but our view is that there are probably between 10 million and 12 million people in this space who cannot get access to everyday financial products. For every customer we take on, we go through a detailed income and expenses process. The average income for one of our customers is £277 per week, which works out at about £14,000 per year—certainly towards the low end of the spectrum. Our customers are slightly skewed towards females—two-thirds are female—and they are relatively young; the majority of our customers are in the 25 to 45 year-old bracket. They are families. The vast majority have children. Many have three or more children.

The thing to understand about our customers is their options. They do not have many. People normally look at our customers by their scorecard—their credit scores—which would normally tell a lender not to lend to one of our customers. They might have what we would call a thin credit file, so there is not much information about the customer. They might not have a mainstream bank account. If there is information about them, it is not much at all, and not enough to take a view about the person's credit history. That works out to be about 20% of our customers.

Alternatively, our customers might have some form of impairment in their credit history. The majority of our customers have had a default at some point in recent history. As a business, we believe strongly in giving our customers a second chance. They might have been turned down by other providers of mainstream credit. They might even have been turned down by other providers of alternative credit. We try to work with our customers to find a rent-to-own solution that really works for them and gets them to a place where they can afford the cost of essential household products.

David Rees: My Lord Chairman, I apologise for being slightly late.

The Chairman: Do not worry about it.

David Rees: In brief, home-collected credit, or home credit as it is more commonly called, is a different system from the systems that both my colleagues described. It involves small cash loans, repayable weekly. The mechanism for contact with the customer is an agent. We think that there are about 16,000 agents in the sector, probably serving around 2.4 million customers—that kind of magnitude. The loan terms are very short: between 26 and 52 weeks is likely to be the range of loan term. The customer is visited at home each week by the agent.

The key feature of home credit is that there are no extra charges. The customer pays a fixed all-in charge. It might be £40 on £100, for instance, over 26 weeks. That is a hypothetical figure, but that is the kind of range. That £40 includes everything. It includes having an agent calling 26 times at their home—or more, if required. There are no extra costs if the customer misses a payment. They could extend that 26-week loan, if they had a problem with their finances, to, say, 50 weeks, and it would still be only £40 on £100. With most credit products, if the customer hits difficulties, they end up paying more by way of default charges and extra interest. Technically, with home credit, the cost of the credit is falling. That is an important distinction, which has been recognised by the regulator.

The system is very transparent, as I have explained. It is very flexible. If you have a problem as a customer, all you have to do is tell the agent when she calls. She may say, "Look, if you cannot pay this week, pay me next week". What often happens in that situation is that the whole set of payments then ratchets on one week. Rather than the loan taking 26 weeks to repay, it takes 27, so the customer can miss one. Some customers like to catch up. That might happen, for instance, if they have been away on holiday. They might say, "Look, I have been away. I would like to catch up and put my account back in order".

It is very simple. It is very transparent. It is very flexible. As we mentioned in our written submission, that offers control for the customer, and if they are on a low income that is extremely important. If they are working on a tight budget, things can happen in their household that would not necessarily derail the budget of a middle-income household,

but it can derail their budget. Therefore, they need systems that can help them through that. That is home credit.

On the specific question about what we have seen regarding the impact on arrears for our sector, I have some interesting data. It is the latest set of figures from Citizens Advice, called *Advice trends*, which it does not produce any more. It is a breakdown, which started for the first time seven or eight years ago, of exactly what Citizens Advice was looking at in its debt cases. We have something like 30 different categories of debt, and only six of them are consumer credit debt. There are arrears of income tax, overpayment of universal credit, rent arrears and telephone and broadband debts. A lot of those debt items are not in fact consumer credit items.

I will send the document to the Committee. What is interesting about it, as I have heard people from Citizens Advice say in recent presentations, is that they are seeing a reduction in the number of consumer credit problem debts and an increase in the number of utility debts. There is an inversion of the normal expectation. I believe that is still valid.

The Chairman: Thank you very much. We have already had written and oral evidence from Citizens Advice. I do not know whether we have that particular paper, so, if you are able to forward it, that would be very helpful.

David Rees: Sorry, but you did ask.

The Chairman: That is very helpful.

David Rees: We had a Competition Commission inquiry into our sector. The Competition Commission asked the advice sector how much interface it had with our sector, and it said it was very little. I have made some calls to members of our association. We are perhaps looking at 0.5% of its customer base, so it is pretty minimal. That is probably in line with most lenders, or with most types of lender.

The Chairman: Thanks. That is a very helpful overview. We will be picking up a number of the points that you raised as we go through the questioning.

Q133 **Lord Haskel:** We have had drawn to our attention the divergence between the interest rates charged by subprime lending companies and those charged by organisations such as credit unions or other third sector lenders. Those people lend to a similar cohort of customers. What are the reasons for that? Also, does it partly explain the decline in payday loans that Russell told us about?

Russell Hamblin-Boone: I cannot speak for home credit, but there is a price control in place in our market, which was designed by the Financial Conduct Authority after rigorous analysis of the market, modelling the impact on consumers and looking to ensure that there could still be a viable market for people who would continue to benefit from short-term lending.

The cost of the loan is made up of the components of each part: the cost of acquisition, the cost of getting a customer, the cost of administering the loan and any cost to do with collecting outstanding debt. Margins are very small now. We have seen a reduction in the market as a consequence of regulation and price control, which will be reviewed in 2017. The cost is reflected by the risk that the lender has to take in lending to people with thin and impaired credit records, and in competing with other markets.

Lord Haskel: Presumably people have similar costs. Why are the charges different?

Russell Hamblin-Boone: The costs reflect the charges. There are no additional charges over and above 0.8% per day interest. Lenders are entitled to charge £15 in total as a penalty fee over the length of the loan, whether it be a loan for three months or for 12 months. They cannot charge more than £15 in penalties, and the loan cannot escalate in interest beyond 100%. If somebody borrows £100, the loan can never exceed £200.

Hamish Paton: The interest rates facing our customers vary significantly. There is payday, which operates in the thousands per cent; there is home-collected credit, which operates in the hundreds per cent; towards the lower end, there are credit unions, which have a cap of 42.6%. Our representative APR is 69.9%.

Your point is well made: how do the costs reflect the charges? On the one hand, you have risk. You are pricing for risk. If we look at our customer base and the choices they have, our customers tend to come from a similar cohort to credit union customers. Some of our customers would not get a loan from a credit union. We take on a broader range of risk. Some of the things that we do with our customers the credit unions would not be able to do.

At the same time, it is important to have in mind the cost infrastructure behind the business. We have a business that is designed around our customers to make sure that there are sufficient safeguards in place such that we can lend appropriately to customers in this space. To give you a sense of the costs, we have 312 stores located up and down the country, often in locations that are convenient for our customers to get to. We have a face-to-face relationship with our customers. We give our customers the opportunity to pay in store every single week in cash. We do not rely on digital platforms for our customers to engage online. You do not need to be an online user to be a BrightHouse customer. In fact, you do not need a bank account if you want to be a BrightHouse customer; 17% of our customers do not have what we would describe as mainstream bank accounts.

We are unusual because we give customers access in a way that many other options do not. We also have a strong sense of support for our customers. That is something we will come back to. What do we do with our customers when they find themselves with problems around paying?

Our proposition is designed to give forbearance to those customers in a way that is appropriate, and that comes with a cost. Although our interest rate of 69.9% is higher than that of credit unions, it is not a million miles away, and it reflects the special service that we give our customers.

Lord Haskel: Your customers get something extra and pay for it.

Hamish Paton: They do.

Russell Hamblin-Boone: We are talking about interest rates as an annualised percentage rate. For a short-term loan, for example, it is not a relevant measure. What you would be looking at is the pounds and pence, and it is £24 for every £100 borrowed per 30 days. We can apply annualised percentage rates only to loans that are beyond 12 months. The figure, regardless of the interest rate, is still £24.

David Rees: I cannot speak for the two sectors that have just given answers. For our sector, the correct response is that it is not exactly the same cohort as you described. Our internal data suggest that only about 3% of our customers are using credit union loans, which is one of the types of lender that you described.

With home credit specifically, we have a weekly collection system at the home. That modifies risk. It is not just us experiencing that; it used to be experienced by local authorities when they collected their rents. When local authorities moved away from fortnightly rent collection, as it usually was, I remember having a conversation with a rent officer in Birmingham, who said, "Our arrears went through the roof". A home collection service, which costs money to provide—probably one of the reasons why local authorities moved away from it—modifies the risk. An interesting piece of research was done by Liverpool John Moores University, where credit unions used loan guarantee funds; in other words, it was money that they did not have to account to their members for. They lent it remotely to home credit customers—very good home credit customers—and what actually happened was that those accounts went into serious arrears. There is obviously a linkage with the regular discipline of the weekly call. It is a routine and a discipline; it is not about enforcement; it is about routine and discipline, which customers welcome. The answer to your question is that it is not necessarily the same cohort.

I will quickly go through the things that affect price in credit, some of which are often missed. Loan size, which we covered in our response, is important. If you are making small loans, you cannot charge the same percentage rate that applies to, say, a £6,000 or £7,000 car loan, because the economics do not allow that. Risk is clearly important.

One sector that perhaps ought to have been represented here today is what used to be called the agency mail order sector, which is one of our main competitors serving the lower income groups in the UK—socioeconomic groups C, D and E, which are our customer base. In the past, mail order people have often said to me, "We serve the same

customers as you". It is a very big sector. Our sector is 2.4 million; we think theirs is probably 5 million. What used to happen was that, if you had a catalogue, your family would buy from your catalogue, so there was a hinterland of customers.

If you supply goods on credit, the Monopolies and Mergers Commission, now the Competition and Markets Authority, calls that an implicit credit charge; in other words, the credit cost is built into the price of the goods. In effect, the credit charge becomes invisible, to all intents and purposes. There is nothing unusual about that. It happens across the world, and it has happened throughout history, but it is an important point when you are looking at pricing. Retail or cash is an important point. Whether or not default charges are charged is an important point. We do not make default charges, so we have to build into our pricing the cost of our customers missing payments, which we allow them to do.

Finally, there is the method of delivery. We use a home-collected system, which the customers like because it modifies risk. They pay a charge for that. As we mentioned in our response, there is an important piece of work by Consumer Focus, which talked about the customer's need for control. Customers are making conscious decisions to buy that control. They know it costs them more, but they would rather have that than a product that appears to be cheaper but is more difficult to control.

Q134 Lord Harrison: Gentlemen, what has been the effect of the cap on payday loan interest rates, introduced in 2013, on the use of products offered by different companies in the sector? David, I turn to you first. Your mention of mail order catalogues sends me back 50 years to my mum, who used to have one. The only person who ever seemed to order from it was her. Other members of the family did not necessarily contribute. That brings me to another world that I inhabit, which is microbusiness and small businesses. Starting with you, David, could you answer the question that I have put regarding the effects, but could you say what percentage? You talked about a different cohort of people. Perhaps some of them are microbusinesses.

David Rees: It is possible that some of them are microbusinesses. In the 1990s, we went into South Africa to see if our product could work there. To our complete astonishment, we found that we were lending to microbusinesses. We knew we were doing that. I think we won an award for it. We withdrew from that market for commercial reasons, but we won an award for lending to microbusinesses. For sure, some people will do that, but that is not our proposition, and it certainly does not come out in our internal figures. There is a small business facet to our industry, in that probably 300 or so members of our association are small businesses, and probably about 200 of those are sole traders.

The payday rate cap—the high-cost, short-term credit cap—does not apply to home-collected credit, probably because we do not put default charges on our product. That seems to be the rationale that was applied. It was based on a political directive to put a price cap on payday lending

specifically, rather than other product formats. I do not think that we can really comment on that.

Hamish Paton: I cannot speak for what has happened in payday, but where there has been any spillover into rent to own, it has been very limited indeed. With the tightening of the availability of credit within payday, do customers then go to different forms? Our product is very different from payday. Payday is used to bridge short-term affordability. People use our product to get ownership of products through a medium-term proposition.

Hearing you talk about catalogues reminds me that it is worth thinking a bit about the heritage of rent-to-own. Back in the day, rental used to be big business across the UK; Granada Rentals and Radio Rentals had more than 2 million customers in their heyday. Interestingly, BrightHouse came into being from Radio Rentals—that is where we originated. The reason why we became rent-to-own was that people renting a TV and making their payments felt they had nothing to show for it at the end. We tailored that proposition and made it rent-to-own. We wanted to give customers ownership, recognising that they liked all the benefits of rental, they liked the flexibility that it gave and they liked the service wrap, but they wanted ownership, too. That is why our rent-to-own proposition is what it is today.

Russell Hamblin-Boone: I can say what happened in the market in that sense. I talked about some of the impact on consumers and about the decline in the size of the market. The average loan size now is about £256, and 80% of customers pay back their loans on time. Only 7.5% of people incur additional penalty fees for missed payments and very few loans are rolled over. That says that the payday sector, as previously defined, is almost non-existent, and we are now talking about a short-term lending sector that gives people loans over a slightly longer period. It gives people the flexibility to pay back those loans in a shorter time than the contractual period. It does not require people to make a single payment in 30 days and then charge them for missed payments. As you can see from the figures, the number of people being charged for missed payments has reduced dramatically.

All of that is very positive, because it shows that the credit market has moved. It has identified that the demand still exists, but it has a better way to provide that demand—a way that is not based on profiting from people missing payments, perhaps in the same way as the credit card industry is, for example. It is much more focused on providing an affordable form of credit. Remember that, in a market for people with thin or impaired credit files, affordable is not necessarily cheap; it is just more affordable.

We asked recently about what has happened to people, and of those who had been turned down because of the new affordability criteria, which meant that lenders had tighter criteria to lend against, around 36% of them said that they borrowed from friends or family instead. Another third said that they went without whatever essential thing they needed,

while 12% said they would cut back on some of their expenditure, and 10% said that they would not have bought what they had originally wanted the loan for or would not have paid bills. Associated with that are the costs that they might have incurred for missing payments.

Other consumers reported that they would turn to alternative sources of credit; 9% said that they would consider pawnbroking and 7% said that they would consider the home credit market. There is no close correlation between our customers, other than store-based customers, and the majority of people using short-term instalment loans. Six per cent of people said that they would use an unplanned overdraft, and 8% would have used a credit card if they had been able to access one. There are alternatives available for some people, but the majority of people who use short-term loans are using them rather than those products, because they do not fit their needs, whether it is the convenience, speed or flexibility of the product.

Q135 Lord Fellowes: This is primarily for Russell. We have been told that there is wide disparity among credit providers in how clearly customers are told about interest rates, insurances, warranties, fees and penalties. That disparity can add significantly to the overall amount paid. Is that the case? If so, why is it the case?

Russell Hamblin-Boone: It is absolutely not the case in our market, partly because the price control means that there is a limit to how much can be charged. The price control also makes things very explicit. Lenders can charge up to 0.8% a day, which equates to £24 per £100 for every 30 days. They cannot charge more than £15 in penalty fees, regardless of the length of the loan. The loan cannot increase by more than 100% of the original size of the loan borrowed.

It is important for customers to know, in pounds and pence, how much they need to pay back. That point is very clear when people are taking out a short-term loan. Because of the simplicity of the product, lenders can state very clearly exactly how much people will pay at the end of their loan term, whether it is three, six, nine or 12 months.

Lord Fellowes: You are really saying that this disparity does not exist.

Russell Hamblin-Boone: There are more complicated credit products.

Lord Fellowes: And some providers would have different or higher standards than others, inevitably.

Russell Hamblin-Boone: The regulation exists, and lenders need to meet the price control.

Hamish Paton: Ours is not a simple financial product. We do not lend money. We offer access to the use of a product. Therefore, for us, the structure of charging is perhaps slightly more complicated. It is really important for us to make sure that we are completely transparent with our customers as to what they are being charged. The breakdown of

those charges and the total payable is displayed on our tickets, in large, across every single product. It is explained online and in our catalogues.

Before any of our customers takes up an agreement with BrightHouse, we spend between 20 and 25 minutes talking through what we call our agreement guide presenter, which goes through each element of the proposition in turn: what it means, what it means for them and how the process works afterwards. We make sure that we invest the time up front, educating the customer as to what it is, what they are getting themselves into and how much it costs.

Q136 Lord Holmes of Richmond: It has been suggested to us that consideration should be given to the establishment of a simple regulatory structure that would limit the amount of income that could be earned from non-lending services by credit firms, pro rata to their direct lending income via interest. What is your view on that?

Russell Hamblin-Boone: As I understand it, that would restrict the profits or restrict the size or amount of loans that lenders can offer.

Lord Holmes of Richmond: It would tie income from non-lending products pro rata to income from direct lending.

Russell Hamblin-Boone: Right. David, do you want to—

David Rees: Sorry, my Lord Chairman, just to clarify, this is where you sell an extra product, as well as the credit. Is that right?

Lord Holmes of Richmond: I am asking about all additional services that credit firms get involved in that are not interest from direct lending services.

David Rees: I can answer that briefly for home credit. A long time ago, we used a form of payment protection insurance, run by the association. It worked very differently from the product that is out there now, but we stopped it many years ago—probably 20 years ago. We do not offer any product. It is purely the loan and the fixed charge on it. It is not an issue for us.

Lord Holmes of Richmond: To answer the question, would you see the introduction of such a structure as a good thing?

David Rees: My personal view is that, if you intervene in a market, things often happen that you do not expect. That is how I would answer that question.

Hamish Paton: It is possibly more relevant to our business. We offer services alongside the straight credit product, but it is important to understand that we offer something in addition to just credit. We offer the opportunity to get access to a product, and to make sure that it is well looked after and insured for the duration of the contract.

One of the interesting things in the market is that there is exposure for customers where the product is not protected. We know from talking to

our customers, in store or through a number of the surveys that we do, that customers feel exposed to one-off costs. You might have heard from Fair for You, for example, about manufacturers' warranties. We try to go beyond that for our customers, because our customers struggle to sustain affordability shocks. What I mean by that is that it is difficult for our customers to pay for a washing machine repair for a machine that is outside its warranty. I was looking at this yesterday. Should the washing machine break down outside its basic manufacturer's warranty, a labour charge will typically be somewhere in the order of £90 to £110. After that, the customer also has to pay for the repair of any parts. We are talking about a significant amount of money for our customers. We seek to offer our customers peace of mind. We know that our customers cannot afford a £200 repair bill, so we try to make sure that the product is protected for the duration of the agreement that our customers have with us. That gives them peace of mind. A lot of the situations that our customers find themselves in are stressful and based on anxiety. The feedback that we have had about our proposition is that they really value the peace of mind that it gives, alongside the basic access to products.

Q137 Bishop of Birmingham: I will move on to another area of that. We have mentioned APR—annual percentage rate. Some of the evidence that we have received from the CCA and the CFA says that it is a flawed indicator. Do you have any proposals for the improvement of that kind of indicator?

Russell Hamblin-Boone: We need to look at simple interest and pounds and pence. People who have cash-flow problems or who need to smooth the peaks and troughs of their household finances need to know what it looks like in money. That is why it is a very simple product. To answer Lord Holmes's point, there are no additional products associated with the short-term loan. It is a very simple and increasingly flexible product. There is no need for anything that makes it more complex.

David Rees: In our response, it was not actually us making the statement about APR; it was the Competition Commission, which said that APR was "a poor measure of the cost of a home credit loan ... We do not consider that the APR is a useful comparator for customers". It was not us saying that; it was the Competition Commission.

Bishop of Birmingham: I understand that.

David Rees: The real problem with APR, or indeed with any measure, is the question of retail credit. What do you do with retail credit? If you try to modify it, you still have the problem that the credit charge can be included in the cost of the goods. APR has a value in certain circumstances. That is clear. The most important improvement that could be made is to make people aware that it has limitations.

Russell Hamblin-Boone: The regulator is the one who set the price cap for our market at 0.8% a day, in full acknowledgement that that is 1,200%-odd in APR. Even the regulator felt that that was irrelevant, because it is about the simple interest.

Bishop of Birmingham: How confident are you that people have the ability to navigate those different categories?

Russell Hamblin-Boone: It becomes difficult. We are looking at working with the price comparison websites to find ways for people to be able to compare loan products. That is counterintuitive when there is a price cap in place, but there is some evidence of variation within the market. Essentially, people ignore the APR, because they are interested in the monthly payment they need to make.

Q138 **Lord Shinkwin:** Hamish, you spoke specifically about support for customers and the importance that you attach to that in what you offer them on behalf of BrightHouse. I invite all three of you to focus on the issue of support, particularly for those at risk of financial exclusion. My question is in two parts. As we know, many customers use the subprime credit sector because they have been refused credit by other providers on account of a poor credit rating, for example. The Committee has been told that a poor credit rating can be a cause of financial exclusion, so could you share with us what alternative checks you might carry out to ensure that people are not forced into arrears? Separately, but linked to that, what precautions do you and your members take to prevent customers falling into financial exclusion, especially in your dealings with customers who fall into arrears?

Hamish Paton: It is important to bear in mind that there are two sides to that. One is affordability, and the second thing is what we do when customers experience financial difficulties. It is worth explaining that BrightHouse has one of the most stringent affordability checks that exists in the market today. We have already talked a bit about credit scorecards and some of the inherent weaknesses in those when dealing with this group of customers. We use credit scoring, but it is just one part of the information dataset that we use with our customers. We have our own bespoke scoring mechanics, which we use, with 20 years' experience in the market, to try to understand the demographics of the customer and what it is about the customer that means they can afford a loan with us.

The affordability piece is most important. You will hear in certain places that it is easy to get a loan; a few clicks of the mouse and the money is in your bank account in five minutes. People do not sign up to a BrightHouse agreement on a whim. They need to prove to us their income and they need to prove to us their expenditure. They bring those two things into the store, and we sit down with them. We try to assess affordability after taking into account all the things that they spend their money on. We validate and verify their income, either through payslips or through bank statements. We then sit down with them and work through their bank statements, identifying each of the different elements of expenditure.

We want to get to a place where at the end of the month they have money left over, money to spend on BrightHouse, but also what we call a buffer, which enables the customer to get through any unexpected surprises in that month. In our world, that buffer is £100. We want to

make sure about income, expenditure and a buffer, and only then can you borrow money from BrightHouse. It is a lengthy process. It takes time; it typically takes anywhere between 90 and 120 minutes to go through that with a customer. It is a thorough, robust check. We do that because we understand that our customers have been excluded from other places, but we try to say yes to our customers, and we can say yes because we invest time in going through their individual circumstances.

Up front, you might say, yes, great, the customer can demonstrate affordability, but what happens if their circumstances change? The one thing that we know about this customer group is that their circumstances are more susceptible to change, so we think through what happens when that occurs. It is worth thinking about the short-term and medium-term problems that a customer may have. In the short term, it might be that they are out of work because they have had a hospital appointment, they have not been paid that week or they have had an unexpected bill of some sort; the boiler has broken down and they have a short-term shortage in affordability. We work closely with the customer to get them back on track. We give them breathing space. Often we reschedule, say, three weeks of missed payments and put them at the end of the agreement. The customer has breathing space, and we can get them through a short-term challenge around payment difficulties.

It is important for us to distinguish a short-term affordability challenge and a medium to long-term affordability challenge. This is one area where our rent-to-own proposition really comes into its own. One of the things that we do, which I guess many other people do, is to reschedule the loan. For example, if the customer has 20 weeks left on their agreement, at £5 a week, and they owe £100, we might extend that to, say, 40 weeks, cutting their payment from £5 a week to £2.50. It is very much in our interests to try to get them to the end of that agreement. There are no extra costs. Yes, it costs us money, but we are trying to get that customer to the end.

Because our proposition is different from payday or home-lending credit, one thing that we can do is to downgrade that product. You have a TV with us. It is a 47-inch TV. It is great—you have enjoyed the use of it—but it is £12 a week and you can no longer afford that. We work with you potentially to downgrade that product, perhaps to a 32-inch TV—a cheaper model, something that is much more affordable and is suited to your new financial situation.

The final thing that I really want to draw out is the idea of returnability in the BrightHouse proposition. It is really different and unique in this part of the market. People can hand their product from BrightHouse back to us and have no outstanding liabilities or obligations to BrightHouse. If they change their mind after four weeks, six weeks, eight weeks, 20 weeks or whenever, they can hand the TV, sofa or washing machine back to BrightHouse, and that is the end of the story. We will take it back. We will not post any black marks on their credit file. We will not call it default or the end of the relationship with us. It is the ultimate forbearance

option, in the sense that the customer can hand it back and they are not trapped into some form of unaffordable debt. Give the product back, return it and that is the end of it.

The Chairman: We are starting to get a bit tight for time. If you want to add anything, can you please do it very succinctly?

Russell Hamblin-Boone: As I have established, ours is a different customer demographic from the one that the other guys here represent. Our customers are people who have non-standard and irregular salaries, and they need to smooth their finances. The important point about affordability is that the businesses that I represent have been heavily scrutinised by the regulator. Because of the regulations that are in place now, their business models have changed fundamentally. It used to be about having big collections teams to recover as much debt as possible that had been lent to as many people as possible. Now it is about doing rigorous affordability checks, which include using big data, advanced technology and analytics to make a decision not only about whether the firm can get its money back, but about whether it is affordable for the customer to take credit. That way, firms reduce the amount of collections costs, because fewer and fewer people are defaulting on their loans. As I said, 80% of people do not incur a penalty fee and pay back their loans on time. As 93% of loan applications are declined, only a very small percentage of applications for short-term loans are successful now. If people get into financial difficulty, lenders freeze the payment—freeze interest—and work with the customer to find a longer-term repayment plan.

David Rees: We use the old system for lending, which is the three Cs: character, capacity and conditions. Modern credit scoring systems produce a proxy for that, but the important difference in home credit is that we get to understand the customer as an individual, as a human being. We get to understand their household as well—the conditions. We understand the character of the customer, which is very important. That is a core element of our system.

The Chairman: We will have to be really brief in both asking and answering questions in order to get through the rest.

Q139 **Baroness Primarolo:** Could you explain why your practice and policy differ between each of you regarding who you are lending to, how much you charge and, importantly, what happens when there are arrears, either when the customer is overindebted or when they get into difficulties? I understand absolutely that you are lending to different cohorts—you made the point clearly—but there is both a commonality in approach and a difference in approach. I want to understand why that is happening.

Hamish Paton: I have just talked a bit about our approach to arrears. I cannot speak for—

Baroness Primarolo: Do you use bailiffs?

Hamish Paton: No, we do not.

Baroness Primarolo: Never?

Hamish Paton: No, we do not. We have some field agents—collections teams who go out to try to reconnect with customers.

Baroness Primarolo: Explain it carefully to me: what is a field agent who carefully tries to reconnect with a customer?

Hamish Paton: We have a weekly cycle of payments. If a customer misses a payment, the way our schedule works in the week is that the payment will be missed on Saturday night. We have found through experience that quickly connecting with that customer gives the customer the best chance to get back on track with payments as soon as possible. Rather than leaving it for a long period of time, we try to get in touch with the customer again on the phone in the early part of the following week.

Baroness Primarolo: I am sorry to interrupt, but you said that your customers come in and pay in the shop.

Hamish Paton: That is right.

Baroness Primarolo: You said earlier that that is part of it. You are suggesting that, when they miss a visit, you quickly follow that up regardless.

Hamish Paton: They have a number of different payment options. They can come into the store. They can pay on the phone. Regardless—

Baroness Primarolo: I am sorry, I am getting more confused. Your earlier evidence was very clear: it was cash, because they did not necessarily have bank accounts, and they came into the shop. You described that as a strength of your business model.

Hamish Paton: I apologise if I misled you. It is not just a cash business. We have a number of different options whereby our customers can pay. Yes, they can pay in the store in cash. They can also pay on the phone. They can pay by continuous debit card authority. We try to give our customers as many different ways of making payments with us as possible.

Yes, we have a process whereby, if a customer misses a payment, we try to reconnect with that customer as soon as possible. We try to do that primarily through the phone, but we have a team of people in the business who go and knock on the customer's door to try to reconnect. We are not trying to repossess the product or intimidate the customer. We are trying to make sure that we get the chance to speak to them. As I have already described, we have strong, positive options to get our customers back on track. We have the breathing space and we have the opportunity to reschedule the loans. We have the opportunity to be

flexible with the product. The most important thing for us is to talk to customers as quickly as possible before the level of arrears builds up.

Russell Hamblin-Boone: The fundamental difference is the rigorous scrutiny that has been applied to our market by the regulator. I am sure the regulator will want to apply that level of scrutiny to the whole credit market, to look at where the drivers are—the drivers for profit and the drivers for incentivising customers to pay, or perhaps even not to repay, and the penalty fees associated with that. In our market, as I have explained, there is a slightly different demographic, but it is a very straightforward product. Lenders now have to treat customers fairly. They are regulated for their conduct, which means that they have to make sure that, with affordability, they are doing something that is in the best interests of the customer, not necessarily in the best interests of the firm.

Baroness Primarolo: Are there any points that you want to make about how your policy differs? Given the pressure on time, we would be interested if you wanted to do a subsequent note. Would that be all right?

The Chairman: That would be very helpful. This will have to be the last question.

Q140 **Lord Empey:** A number of submissions to the Committee expressed concern that tighter regulation could mean higher-risk customers resorting to illegal lenders. Does that mean that tighter regulation should be avoided? If tighter regulation means that the legal credit market becomes inaccessible to some customers, does your industry have a role to play in helping them to find other, legal alternatives?

Russell Hamblin-Boone: Absolutely. There is concern about people being turned down for certain financial products and, therefore, resorting to illegal lenders. It is important to note that it is very easy to characterise an illegal lender as somebody operating in the community, which they do, using aggressive and violent tactics to recover debt. There is also the risk of an illegal online market, which is much more difficult to regulate and track, especially when the loan sharks are, effectively, operating outside the UK. There is a risk there. It is easier for someone to recognise a loan shark in the physical sense as opposed to the digital sense. We need to be aware of that. From our research, 6% of people said that they would consider using, or had used, an illegal lender, whether it was somebody in the street or somebody online. As responsible businesses, we lobbied the Treasury to continue to fund the illegal money-lending team in England and Wales. We all have a responsibility for the levy, which, thankfully, is now being applied to the whole of the credit market. Certainly, more can be done, as was presented by the previous witnesses, to make the judicial process much stricter and to make loan sharking a specific criminal offence.

David Rees: The simple response to the question is that illegal lending exists. It is a natural market response to regulation. Therefore, if

regulation is tightened, those who are doing the tightening need to be aware of that risk and to factor for it.

Hamish Paton: Building on that point, in a world of tighter regulation, the demand for credit in these forms does not go away. Typically, there is less supply, which perhaps means that some of the people who need credit most can no longer access it in a regulated form, so moving towards an unregulated form is definitely a possibility. It tends to get talked about in terms of family, friends and acquaintances, but it is very much a feature of what will happen should regulation tighten further.

Q141 **The Chairman:** As we sign off, could all three of you, in one sentence, say one thing that you would like to see the Committee focus on? What would it be? Just one sentence each, please.

David Rees: The evidence—empirical evidence.

Hamish Paton: There is a desire to make sure that the supply of credit to the market is well regulated and responsible, and I totally concur with that. At the same time, demand is not going away. Whatever the Committee can do to think about increasing competition in this space, getting more people providing opportunities for those customers, with better competition and more providers, will lead to better outcomes for customers.

Russell Hamblin-Boone: I agree with those two points but, to prevent financial exclusion, we need to look at rewarding people for good borrowing behaviour, regardless of the credit products they are using. Particularly in the past, but also when people talk about it now, there tends to be stigma associated with being a payday customer. Actually, if a payday customer has paid off their loan well and demonstrated good borrowing behaviour, why is the credit reference agency not saying, "That is good", so that they start to transition into mainstream, cheaper products?

The Chairman: That is a very helpful point. Thank you very much, all three of you. It has been a very interesting session. Thanks very much for giving us your time and thoughts. We appreciate it.