The changing face of the short-term credit market

An extract from Perspective:
The affordability and responsible lending issue
Essential insights into the issues facing your industry today

An industry commentator talks to Perspective about how the short-term credit market is transforming before our very eyes.

The short-term credit market has changed: it's no longer short-term in the way we have always known it.

Rewind 12-18 months and those who wanted to borrow over a period of days needed to do no more than carry out a simple Google search. The results would show any number of lenders offering them the chance to take out a loan over a period of days.

Now if you try to search for those same companies, you will find that they have not disappeared, as many in the industry expected after the FCA's introduction of a price cap, but are now instead offering larger loans for longer periods. As detailed in the Consumer Finance Association's recent Credit 2.0 report, short-term lenders have evolved their products to continue to appeal to consumers' needs. Most of the larger players in the market now offer slightly larger instalment loans over a number of months and early customer feedback has been positive.

So what does this mean?

Given that classic short-term borrowers are now being offered larger and longer lines of credit, this places an even bigger emphasis on the much-discussed notion of affordability.

Can they afford it?

The FCA has made it extremely clear that it expects lenders to be carrying out extremely stringent affordability assessments, both at the point of application and on an ongoing basis.

Lenders who move to provide what are generally known as 'instalment loans' need to ensure that their lending decisions make a similar migration.

The FCA is likely to be of the opinion that it is easier for consumers to manage a one-off, short-term product with one repayment than to manage a larger loan over a period of many months at prices that still fall under the High-Cost Short-Term Credit bracket.

Can lenders afford not to check?

With this in mind, the FCA will expect affordability assessments to become even more stringent and take into account the higher amounts being borrowed over longer periods.

Having made it clear through numerous different publications, as well as regulatory enforcement action, that the affordability assessments being carried out by the market on the previously popular short-term loans were falling far below expected standards, lenders have a big job to do to ensure that their decisions on instalment loans meet the approval of the FCA.

With complaints data over the last 12 months from bodies such as the Financial Ombudsman Service (FOS) and Citizens' Advice dominated by consumers querying their lenders' decision to provide them with credit, this issue doesn't look like it's going away any time soon.

The FCA monitors complaints data from bodies such as the FOS, and consumer credit firms, once they receive full authorisation, will have to periodically report complaints data to the regulator. If those figures show high levels of complainants unhappy at lending decisions, the risk of investigation and enforcement action is real.

Unless lenders begin to tighten up their affordability assessments further, using as much data and as much granularity of data as possible, they run the risk – more than ever – of facing balance write-offs and enforcement action.

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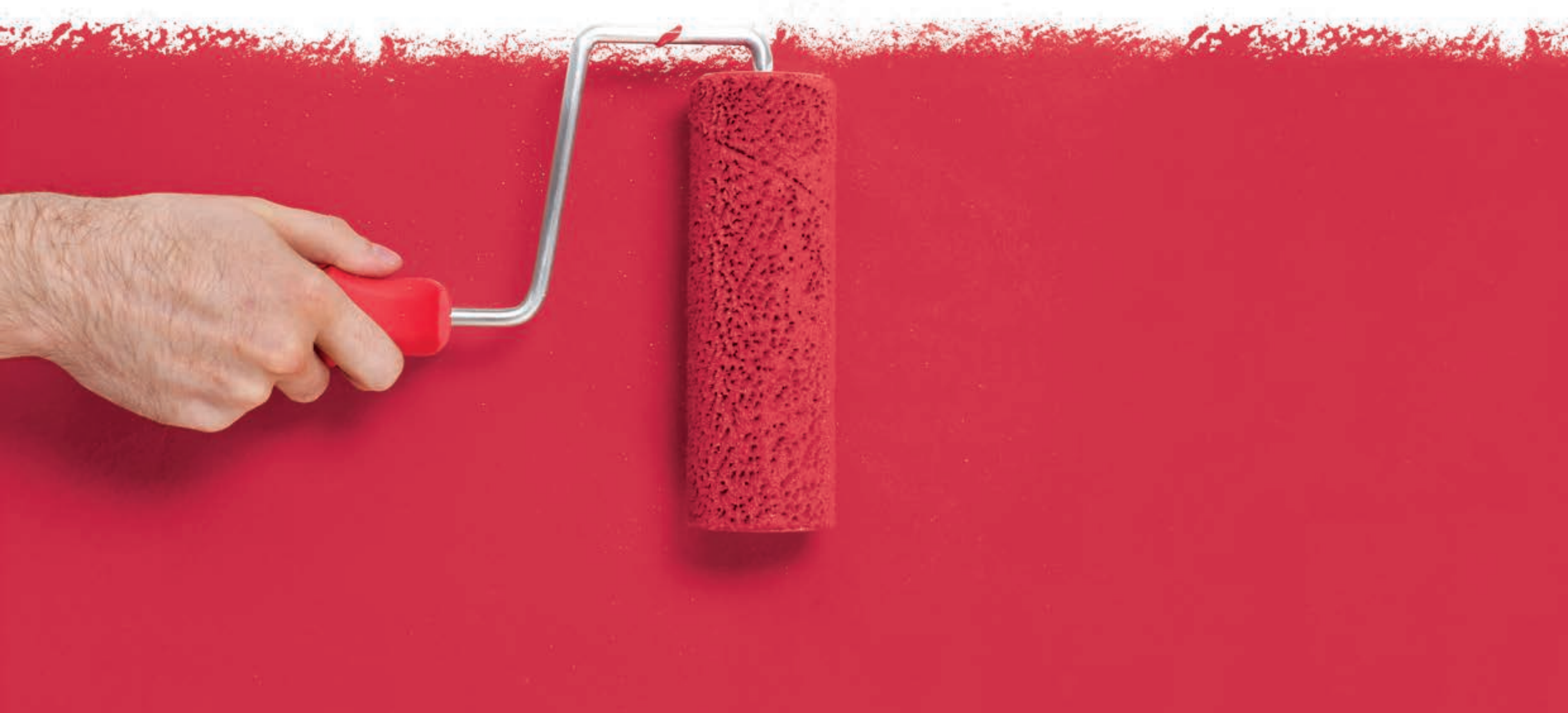

Russell Hamblin-Boone, Chief Executive of the Consumer Finance Association, *shares his response to our commentator.*

Inevitably the short-term credit market has evolved. The FCA's rules, including a cap on the amount that lenders can charge, have created a new lending landscape and there are now fewer lenders granting fewer loans, yet the demand for short-term credit remains high.

The commercial reality is that single-payment loans are not viable for many lenders and have been replaced with longer term instalment loan offers of three to six months.

But the value of the loans has not increased significantly. Early signs are that debt repayment levels are higher, partially because the increased loan duration gives borrowers more opportunity to smooth their finances in a sustainable way.

New rules mean that lenders have imposed tighter lending criteria on their customers and loan approval rates have declined by 70%. As lenders work through the FCA's authorisation process, they are refining the affordability checks made during the application stage.

Let's get digital

A key feature of the market is the use of digital technology which has reformed the way short-term lenders make lending decisions, and meets the needs of modern consumers for quick but rigorous lending decisions. Short-term lenders are leading the financial services market in data analysis to assess risk and through real-time data sharing.

The FCA's recent thematic review found that short-term lenders are on a path of improvement, which is evidenced by the latest data from Citizens' Advice, which shows the number of payday loan cases has halved in the last year. However, during 2014/15, the number of complaints to the FOS about payday loans increased by 46% to 1,157. This increase reflected the proactive attempt by the FOS, supported by Citizens' Advice, to encourage complaints about payday loans. Nevertheless, this figure is dwarfed by the 329,509 total of new complaints about financial services.

The consequences of regulation

As one of the first markets to be scrutinised under the new FCA regulatory regime, short-term lenders are setting the standard for affordability assessments that will be required for all consumer credit products. Short-term loans account for less than 1% of all unsecured consumer credit, but the regulator's intervention in this market clearly demonstrates its objective to improve conduct and culture across the financial services sector. The early experience of HCSTC firms is a lesson to all other firms facing FCA supervision.