

Doorway to debt

Protecting consumers in the home credit market



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Summary

Home credit is one of the largest high-cost credit markets in the UK, with more than 1.6 million customers. It is also the form of high-cost credit used most commonly by clients who come to us for help with their debts. Citizens Advice helped an estimated 30,000 people who were struggling with home credit debts last year.

Problems in the home credit market fall disproportionately on the most vulnerable within society. Our analysis of client data shows that people who are struggling with home credit debts are particularly likely to be in vulnerable circumstances. Clients are typically female, out of work, on low incomes, and living in social housing. Nearly half (48%) have a long-term health condition or disability, compared with 18% of adults in England and Wales. Many are behind on household bills like council tax or water rates.

While home credit borrowing can be a lifeline for many customers, evidence from our advisers suggest that, for clients like these, unaffordable home credit loans contribute to worsening financial situations. Our research highlights three key factors which lead to poor outcomes for consumers:

1. **Some clients are offered loans which are unaffordable.** Citizens Advice regularly sees cases where clients who are already struggling to keep up with debt repayments are provided with additional credit.
2. **Customers are taking on multiple loans.** A third (34%) of home credit clients had outstanding debt on two or more home credit loans.
3. **Loan refinancing is causing costs to spiral.** We estimate that customers can end up paying more than double what they originally borrowed in interest on up to 490,000 home credit loans.

We are calling on the Financial Conduct Authority (FCA) to extend its definition of high-cost short-term credit to include home credit loans.

The FCA's regulation of payday lending has been one of its big successes - consumers are paying less for loans and more are able to repay on time. Removing the exclusion which omits home credit from these regulations would provide valuable consumer protections to home credit users, by:

- Limiting the number of times each loan can be refinanced
- Ensuring consumers never pay back more than twice what they borrowed

We estimate that, were existing loans to be priced down to this cap, it could save consumers up to £123m on up to 540,000 loans.

Introduction: What is home credit?

Home credit loans - or 'doorstep loans' - are a form of high-cost credit where payments are collected on a weekly or fortnightly basis from customers' homes. Home credit loans are typically for smaller amounts compared to other unsecured loans. The value of an average new home credit loan in 2016 was £770, and loans offered by lenders usually range from £100 to £1000. Annual Percentage Rates (APRs) range from 62% to 1558%.

Unlike other forms of high-cost credit, the amount of interest that customers pay is typically agreed in advance and included in the agreed schedule of payments. Lenders do not usually charge default fees or additional interest as a result of missed payments.

Home credit is one of the largest high-cost credit markets in the UK. The FCA has found that 700,000 people took out a home credit loan in 2016.¹ 1.6 million people had outstanding debt at the end of that year, with an overall value of £1.1 billion.²

Figure 1: Advertised loans among the largest home credit providers

| | Customers (2016) ³ | APR (advertised) | Term | Cost of £400 loan (advertised) |
|----------------------------|-------------------------------|------------------|-----------|--------------------------------|
| Provident ⁴ | 900,000 | 1557.7% | 13 weeks | £172 |
| | | 535.3% | 26 weeks | £224 |
| | | 299.3% | 52 weeks | £348 |
| Morses Club ⁵ | 200,000 | 756.5% | 20 weeks | £200 |
| | | 433.5% | 33 weeks | £260 |
| | | 272.5% | 52 weeks | £328 |
| Mutual ⁶ | 40,000 | 188% | 26 weeks | £120 |
| | | 104% | 51 weeks | £160 |
| | | 61.5% | 102 weeks | £220 |
| Loans At Home ⁷ | 95,000 | 433.40% | 33 weeks | £260 |
| | | 340.00% | 45 weeks | £320 |

¹ [Financial Conduct Authority \(2017\) High-cost credit: Feedback Statement FS17/2](#)

² [Citizens Advice \(2017\) Debt on your doorstep](#)

³ Figures were gathered from respective companies' Annual Reports or websites in 2017.

⁴ <https://www.providentpersonalcredit.com/> (figures correct as of 14th March 2018).

⁵ <https://www.morsesclub.com/> (figures correct as of 14th March 2018).

⁶ <https://www.mutual.uk.com/> (figures correct as of 14th March 2018).

⁷ <https://www.loansathome.co.uk/> (figures correct as of 14th March 2018).

Part 1: Why are we concerned about home credit?

Between 2017 and 2018, Citizens Advice helped an estimated 30,000 clients with home credit debts.⁸ This makes it the form of high-cost credit we most commonly see amongst our debt clients.

Figure 2: High-cost credit debt clients by type of debt (Q3 2016/17 - Q2 2017/18)

We analysed data gathered from Citizens Advice clients during specialist debt advice sessions to give us an insight into the characteristics of home credit users who end up struggling with their debts.

Clients with home credit debts are more likely to be vulnerable

This analysis shows that home credit users who struggle with their debts tend to be female, on a low income, and living in rented accommodation. The median net annual income for clients we help with home credit debts is £14,245. More than 9 in 10 (91%) of clients with home credit debts are renters including 62% in social rented accommodation and 27% in private tenancies.

Our analysis also shows that people with unaffordable home credit debts are more likely than our debt clients to be in vulnerable circumstances:

- **Only a third (32%) of clients with home credit debts are in employment.** This proportion is lower than for Citizens Advice debt clients generally (40%) and almost half that of the general population (62%).
- **Nearly half (48%) of clients we saw with home credit debts have a long-term health condition or disability.** This is higher than for all debt clients (40%) and more than twice the rate amongst the general population (18%).
- **A third (32%) of client with home credit debts are single parents,** compared with a quarter (24%) of all debt clients and only 8% of the general population.

⁸ Citizens Advice does not currently record doorstep loans as a separate advice issue and so it not possible to give an exact figure of clients who received advice for doorstep loan problems. Our estimation is based on data from the first three quarters of the year from Q3 2016/17 to Q2 2017/18. Over this period 59,769 unique clients received advice for 'unsecured personal loan debts'. Of these, 15,540 (26%) had their details recorded in our electronic case recording module for complex debt casework. In the first three quarters, 5,938 unique clients were identified in this group as having doorstep loan debts, which we assumed to be 7,917 over the entire year. This gives an estimated 30,451 clients who received doorstep loans advice.

As not all debt clients progress to this level of advice, the data in this report cannot be generalised to all home credit users. Nonetheless, our client characteristics closely match those of all home credit users as we found in previous analysis of the Wealth and Assets survey.⁹

Analysis of case notes recorded when people are given debt advice shows that people's vulnerability often contributes to their overindebtedness, as the case study below illustrates:

Case study: Hannah

Hannah came to Citizens Advice accompanied by her support worker, David. She has severe learning difficulties and is therefore supposed to be accompanied by an appropriate adult whenever she makes financial decisions.

Hannah had previously taken out loans through a home credit provider. David informed us that it had been explained to them that Hannah needed an appropriate adult with her. Despite this, her lending agent had been calling when Hannah was alone and offering her new loans.

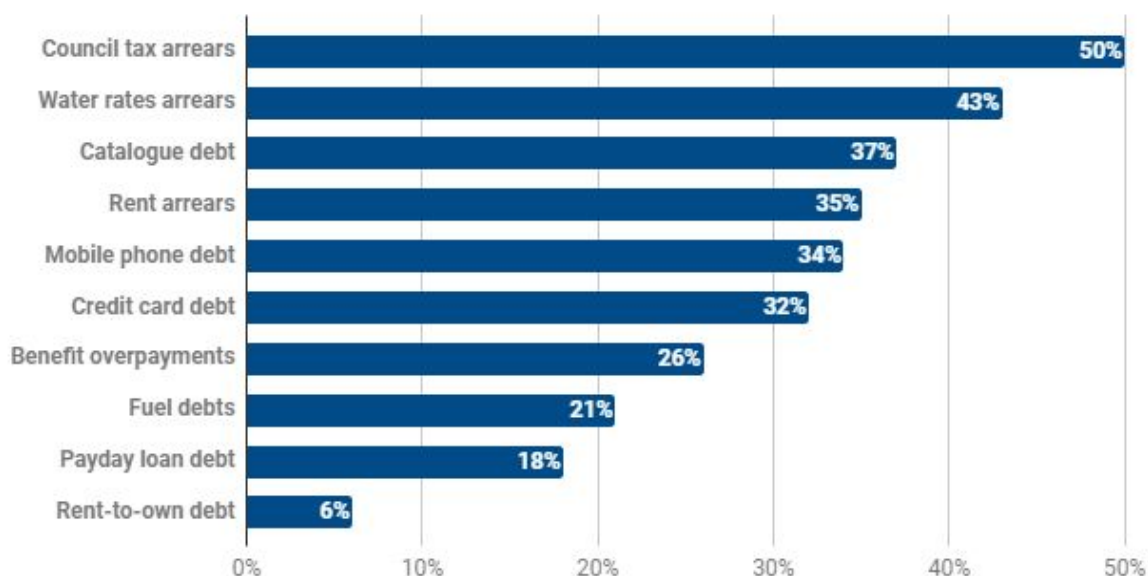
As a result, although Hannah has enough income to get by on, she now holds more than £3000 in home credit debts and is struggling to afford repayments alongside her day to day spending.

⁹ [Citizens Advice \(2017\) Debt on your doorstep](#)

Clients with unaffordable home credit debts are severely overindebted

Amounts owed by our clients to doorstep lenders tend to be relatively small when compared with other types of debt. The median value of the home credit loans held by our clients is £455. However, looking at their debts more generally, the people we help with home credit loans are highly overindebted.

Figure 3: Proportion of home credit clients with other types of debt



Half of home credit clients are in arrears on council tax and 43% are behind on water bills. Nearly 2 in 5 (37%) hold catalogue credit debts while a third (32%) have credit card debts. Whilst our data does not allow us to look at the circumstances which led to clients getting behind on other bills, we do know that clients with home credit debts in a difficult and risky financial position.

What is more, previous research from Citizens Advice has shown how home credit lending practices and the personal nature of relationships between creditors and debtors can mean that clients feel under pressure to prioritise repaying loans above other household bills.¹⁰ Although this form of lending is often valued by customers for its convenience, the personal nature of doorstep loans means clients may be put under greater pressure by lending agents than by other creditors. This can cause clients to overlook priority debts like household bills.

¹⁰ [Citizens Advice \(2017\) Debt on your doorstep](#)

Home credit debts make up a small but significant part of the overall debt for people we help with home credit issues. The median home credit debt to income ratio is 5%, though this rises to 10% amongst clients on the lowest incomes.

Figure 4: Debt and income of home credit clients, by income quintile

| | 1st | 2nd | 3rd | 4th | 5th |
|-------------------------------------|--------|---------|---------|---------|---------|
| Median home credit debt | £529 | £600 | £639 | £660 | £834 |
| Median income | £5,972 | £10,504 | £14,250 | £16,134 | £24,556 |
| Median total debt | £5,021 | £5,987 | £6,838 | £7,141 | £8,727 |
| Debt to income ratio (home credit) | 10% | 6% | 5% | 4% | 3% |
| Debt to income ratio (overall debt) | 85% | 57% | 49% | 44% | 34% |

Our casenotes show that clients often turn to home credit borrowing because they are already having difficulty keeping up with their day to day spending, as the case study below shows:

Case study: Larissa

Larissa works full time but her hours vary from week to week. Her income can be £1,200 one month, but £900 the next. She also struggles to pay her utility bills because she is not paid on the same day each month.

When Larissa came to Citizens Advice for help, she owed nearly £4,000 to one home credit provider, and £400 to another. She also had council tax arrears, fuel debts, and TV licence debt.

Home credit borrowing can exacerbate money problems

Home credit users tend to have little or no access to mainstream lending, typically because of a poor credit rating. While high-cost credit is an expensive form of borrowing, it may be one of a limited number of options available to people on low incomes. The high cost of borrowing through home credit loans reflects a higher risk of default amongst the customer base.

Nonetheless, we know from Citizens Advice adviser casenotes that where home credit loans are not affordable, they can contribute to a worsening of clients' money problems.

Evidence produced by the FCA seems to support this. A recent report found that credit scores of home credit users deteriorated significantly between 2015 and 2017.¹¹ It also showed that the level of debt held by home credit users has been rising as a proportion of their income - from 10% in 2015 to 22% in 2017.

One possible explanation is that home credit is a *cause* of financial distress. Most of the clients who come to us for help with their home credit debts are struggling to keep up with essential bills and living costs. Committing a significant proportion of their income to debt repayments makes it harder for them to address future financial problems. In cases where clients feel under pressure to prioritise repaying their home credit debt, they can fall behind on more important bills like rent or council tax.

¹¹ [FCA \(2017\) High-cost credit: Feedback statement](#)

Part 2: Why does home credit lead to problem debt?

As shown in Part 1 of this report, home credit users are frequently in difficult and deteriorating financial circumstances. But unaffordable home credit debts aren't just a symptom of financial difficulties - they're a cause. The nature of home credit loans can push people into a spiral of debt. A 2013 study, for example, found that half (52%) of home credit customers felt this type of credit had trapped them in a cycle of borrowing.¹²

Home credit loans are typically repaid in weekly or fortnightly cash payments made to a lending agent who visits customers at their home. Whilst previous research has shown that home credit customers value the convenience that this model provides, it also gives rise to particular concerns about lending practices.

¹³

Our research shows there are three factors which contribute to poor outcomes and problem debt amongst home credit customers:

1. Some clients are offered loans which are unaffordable
2. Customers are taking on multiple loans
3. Loan refinancing is causing costs to spiral

Lenders offer loans which are unaffordable to some customers

There is evidence to suggest that home credit lenders are providing loans which are unaffordable to their customers. Citizens Advice advisers see cases where clients who are already struggling to keep up with debt repayments are provided with additional credit. Others are offering loans to clients who, because of specific vulnerabilities or mental health problems, are not in a good position to make financial decisions.

There are several potential reasons for this. Our advisers have reported several cases where clients say their home credit lender did not conduct checks to see whether their loan was affordable. In the case of repeat borrowers, it's possible that lending agents who have got to know their clients feel that repeating these checks for subsequent loans is unnecessary.

Alternatively, it may be that the checks being carried out do not capture whether a loan is affordable for the customer. There is a danger that in assessing the risk

¹² [University of Bristol \(2013\) The impact on business and consumers of a cap on the total cost of credit](#)

¹³ [University of Bristol \(2013\) The impact on business and consumers of a cap on the total cost of credit](#)

that customers may default on their loans, home credit lenders are not giving sufficient consideration to the risk that the loan will have a significant adverse impact on borrowers' lives.

Although this may be difficult for lenders to assess, casenotes from Citizens Advice advisers show that lenders can fail to give due consideration to affordability even when they have sufficient information:

Case study: Temi

Temi recently came to Citizens Advice for help with his debts, which totalled over £22,000. He told his adviser that he has significant mental health issues and had experienced several breakdowns in recent years. During these periods, he knows he is particularly vulnerable to taking on extra debt.

Temi had already successfully paid off a home credit loan. Knowing that he would be unable to afford further credit, he asked his home credit provider not to lend to him again.

However during his most recent breakdown, his home credit lender allowed him to take out another loan. He is now in arrears and this has contributed to pushing him over the limit for a Debt Relief Order. Temi is now facing bankruptcy and is frustrated that there was nothing in place to stop him taking out further credit.

Home credit customers are taking out multiple loans

Many home credit customers take on multiple loans, increasing what they owe in weekly payments and making it difficult for them to keep up with other financial commitments. A third (34%) of home credit clients had outstanding debt on two or more home credit loans.

Figure 5: Proportion of home credit clients with multiple home credit loans

| Number of home credit loans | % of clients | Median total home credit debt |
|------------------------------------|---------------------|--------------------------------------|
| 1 | 66% | £500.00 |
| 2 | 20% | £890.00 |
| 3 | 6% | £1,151.50 |
| 4 | 3% | £1,201.41 |
| 5 or more | 4% | £2,247.36 |

Unsurprisingly, our data suggests that as clients take on more loans, they take on higher levels of debt.

It's common for home credit customers to take on loans with the same lender. Citizens Advice casenotes show examples where clients took out new loans with a home credit provider when they got into financial difficulty because they had an existing relationship and felt confident they would be accepted for additional credit. We also see cases where customers take out a new home credit loan immediately after making the final payment on an existing loan.

This relationship provides home credit customers with easy access to credit. However, it also means there is very little pressure on home credit lenders to provide customers with a good deal.

People with existing debts and poor credit ratings are unlikely to be able to shop around to find better terms on which to borrow. What is more, as home credit users are often in difficult financial situations, customers are likely to feel they need additional credit urgently. They therefore have less time to consider their options and are less likely to make decisions based on the price offered by lenders, as the below example demonstrates:

Case study: Vanessa

Vanessa came to Citizens Advice for help with managing her money because she had incurred court fines and was having difficulty budgeting in order to balance payment of these against repaying other debts.

Whilst Vanessa was in the process of working with Citizens Advice to address her outstanding debts and arrange an affordable repayment plan for her debts, her adviser discovered that she and her husband had taken out a new loan from their home credit provider as they made their last payment on an existing debt. They explained that they had borrowed again in order to buy a new tumble drier and to have money for Christmas presents.

Despite the fact that Vanessa was already struggling to keep up with her existing debts, she was allowed to borrow additional money from a home credit lender. Whilst their original loan was for £500, the cost of interest meant that they owed a total of £1092 - equivalent to weekly payments of £21 over the course of the year. Vanessa and her husband will now have to pay back more than double what they originally borrowed.

Loan refinancing is causing costs to spiral

The other way in which home credit customers can find their debts spiralling is through loan refinancing offered by lenders. Previous research has found that between 30% and 40% of new loans are used to refinance an existing loan.¹⁴

Data from debt advice appointments does not allow us to see where clients have refinanced a home credit loan. But evidence submitted by Citizens Advice advisers shows several cases where customers who were struggling to keep up with weekly payments were pressured by lenders to refinance their loan rather than agreeing an affordable repayment plan. Others were allowed to refinance their loans despite being in serious financial difficulties, as demonstrated in the case study below:

Case study: Nigel

Nigel came to Citizens Advice because he was struggling with unaffordable debts totalling nearly £20,000. Nigel is the lone parent of an eight-year-old child, and has an ongoing mental health condition. As he works part time and has an income of under £1000 a month, he is having difficulty keeping up with his debt repayments.

Nigel has a loan with a home credit provider totalling just over £1000. Despite his financial difficulties, his lender has refinanced his loan multiple times. According to Nigel, his lending agent had not questioned his financial situation when refinancing his loan.

As noted above, an important aspect of home credit lending is that payments are collected in person from customers' homes, meaning a more informal relationship between lending agents and customers.

The potential downside to this approach is that it makes it more likely that customers will agree to refinancing terms offered by their home credit lender, rather than looking around at other options for borrowing. With few competitive pressures, customers may be paying over the odds for credit.

Similar trends were previously observed in the payday loans sector. Prior to the introduction of the total cost cap on short-term high-cost credit, an Office of Fair Trading report found that more than 1 in 4 (28%) of payday loans were refinanced - suggesting a customer base which was largely captive.¹⁵ The report

¹⁴ [University of Bristol \(2013\) The impact on business and consumers of a cap on the total cost of credit; CMA \(2006\) "Home credit market investigation", Final report.](#)

¹⁵ [Office of Fair Trading \(2013\) Payday Lending: Compliance Review Final Report.](#)

also showed that proceeds from refinanced loans made up half (50%) of payday lenders' revenues.

At advertised rates, home credit customers are not charged more than 100% of the original value of their loan in interest. However, modelling of the home credit sector commissioned by Citizens Advice suggests that refinancing can push the cost of borrowing over 100%.

Our analysis, which is discussed in more detail in Part 2 below, found that consumers end up paying back more than twice what they borrowed on up to 490,000 home credit loans each year due to refinancing.¹⁶ Refinancing increases the cost of borrowing as borrowers pay a greater amount in interest when they have a larger outstanding balance.

¹⁶ That assumes that around 43% of loans are refinanced and the impact of refinancing is to extend the length of each loan by 50%. The model is explained in more detail on page 14. The total figure is the number of loans in a year that would incur more than 100% of the original value of the loan in interest.

Part 3: Protecting consumers in the home credit market

While home credit loans can be a lifeline for people with no access to mainstream credit who are struggling with money problems, if those loans are not affordable they can exacerbate financial difficulties.

Citizens Advice advisers see cases where already vulnerable clients are paying exorbitant prices for home credit. Greater consumer protections in this market could help reduce the price that home credit customers pay and encourage lenders to give greater consideration to whether loans are affordable for their customers, helping clients like the one below:

Case study: Shawna

Shawna visited Citizens Advice because she was finding it difficult to manage debts she had accrued on household bills and high-cost credit. Her husband had borrowed £1,500 from a home credit lender 14 months previously. Because of the high rate of interest, they were asked to repay a total of £3,432 - more than double what they originally borrowed. Whilst Shawna's husband had been making payments for more than a year, they still owed £2,418.

When they came to Citizens Advice, Shawna and her husband were finding it extremely difficult to cope with the payments, and the huge balance still owed due to the extortionate interest rate. Shawna reported that she was suffering with anxiety and general poor health because of the stress.

What policy changes would help protect consumers?

The FCA's regulation of payday lending has been one of its big successes since it took over consumer credit regulation in 2014. The two key protections given to payday loan customers - from multiple refinancing and from paying back more than twice what they borrowed - have resulted in a dramatic improvement in customer outcomes. Since their introduction:

- Citizens Advice has seen a fall in people needing help with unaffordable payday loan debts by around half - from more than 16,000 people in 2013-14 to less than 9,000 last year.

- FCA analysis shows that improvement reflects improvement in the market more generally. The proportion of loans entering arrears for seven days or more similarly reduces from 16% to 12%.¹⁷

The FCA should build on that success by extending the same protections to home credit consumers.

Recommendation 1: The FCA should extend its definition of high-cost short-term credit to home credit

Currently all products where the APR is more than 100% where the loan has to be mostly re-paid in 12 months are defined by the FCA as 'high-cost short-term credit'. However, despite often meeting these criteria, home credit has been excluded from the definition.¹⁸ Extending the definition of high-cost short-term credit to home credit, by removing that exclusion, would provide consumers in that market with two key benefits:

i. Limiting the number of times each loan can be refinanced

Payday loan customers are only able to refinance loans twice,¹⁹ unless the purpose is for forbearance.²⁰ Some protection from refinancing already exists for home credit customers - lenders should only let consumers refinance where it wouldn't make repayments unsustainable²¹ and where it is in a customer's best interest.²²

The protections for payday loan customers are more complete. In addition to limiting refinancing to twice per loan, payday loan providers cannot refinance a loan if that might be harmful to the consumer,²³ or if refinancing the loan means the cost of borrowing would be more than twice the original sum borrowed.²⁴

Restricting the number of times home credit loans can be refinanced would protect borrowers from spiralling costs and help prevent them from getting trapped in persistent debt.

¹⁷ FCA (2016) [High-Cost Credit: Call for input](#)

¹⁸ <https://www.handbook.fca.org.uk/handbook/glossary/G3328.html>

¹⁹ CONC 6.7.23

²⁰ CONC 6.7.17 where the result is that no interest accrues at any time in relation to that agreement or any which replaces, varies or supplements it from the date of the refinancing and either: (a) there is no charge in connection with the refinancing; or (b) the only additional charge is a reasonable estimate of the actual and necessary cost of the additional administration required in connection with the refinancing.

²¹ CONC 6.7.18

²² R01/04/2014(2)

²³ CONC 6.7.21

²⁴ CONC 5A.2.10

ii. Ensuring consumers never pay back more than twice what they borrowed.

Currently payday loan customers have three protections from high charges. They are:

- A total cost cap which means people cannot repay more than the amount they borrowed in interest and charges.²⁵
- An initial cost cap - which means interest charges cannot be more than 0.8% per day.²⁶
- Lenders can only charge a maximum of £15 in additional fees and charges.²⁷

As shown in more detail below, home credit consumers - who don't have these protections - can end up repaying more than twice what they borrowed. Currently, that is largely the result of refinancing.

While refinancing is the main cause of the cost of home credit loans exceeding twice what people borrowed. Limiting refinancing alone would create a risk that lenders would simply shift the high-costs on to borrowers in other ways - for instance through late payment fees or higher initial interest rates. The full package of protections from high-prices in the payday loan market is effective because it limits the ability of lenders to shift the cost of borrowing.

Recommendation 2: The FCA should require high-cost short-term credit providers to conduct better affordability checks

Our evidence shows that as well as paying high costs, large numbers of home credit consumers are simply being lent money they can't afford to repay. The median debt to income ratio of people we helped with home credit debts was 49%. In the home credit market more widely, the median debt to income ratio is 22%.²⁸

The FCA should introduce rules for high-cost short-term credit providers to give clarity over what is expected when they conduct affordability checks. Currently, while all lenders have to conduct affordability checks, there are no rules on what those checks have to include.

²⁵ CONC 5A.2.2

²⁶ CONC 5A.2.3

²⁷ CONC 5A.2.14

²⁸ FCA, (2017) [High-cost credit feedback statement](#)

The FCA should make its guidance in the Consumer Credit Sourcebook on responsible lending into rules or high-cost short-term credit lenders. As a minimum those rules should require lenders to check proof of income and expenditure when making lending decisions.

How would a price cap affect existing home credit loans?

Extending the definition of high-cost short term credit to include home credit would result in the price cap on payday loans applying to home credit loans. In order to explore this recommendation in more detail, we commissioned Lucerna Partners to develop a model which would help us explore the impact of a similar price cap on existing home credit loans.

Our model is limited by a lack of available data on the home credit market - particularly on actual APRs paid by customers and the terms upon which home credit loans are refinanced. It therefore relies on reasonable ranges of assumptions about the characteristics of, and proportion of loans in, each part of the market.²⁹

The price cap is made up of three parts. Our model looks at the impact of the two that would have an impact in the home credit market:³⁰

- The cost cap of 100% which means that customers cannot repay more than the amount they originally borrowed in interest and charges
- The initial cost cap which limits the interest charged to a maximum of 0.8% per day.

The model helps to illustrate when a price cap could have an impact in this market. **We estimate that if the price cap on payday loans was extended to the home credit market, it would affect between 410,000 and 540,000 loans a year. Were existing loans to be priced down to the cap, it could deliver savings of between £43m and £123m in interest charges for home credit customers.**

The lower estimate assumes that all consumers get the representative APR from each lender and that the impact of refinancing is to extend refinanced loans by an average of 30%. The upper estimate assumes 25% of customers get an APR which is higher than the representative and that the impact of refinancing is to extend refinanced loans by 50% on average.

²⁹ A full methodology is available in Appendix 1

³⁰ The four big home credit lenders don't currently charge default fees which means the third part of the cost cap - a £15 cap on default fees - would have no impact

The total number of loans affected and money saved is based on a combination of loans that cost more than 0.8% a day and loans where the total cost is over 100% of the capital borrowed. Home credit loans are only affected by the 0.8% cap where the APR is variable. In the upper bound version of our model we estimate up to 30,000 loans a year would be affected by the 0.8% cap.

The majority of loans affected are due to the total cost being pushed over 100%. In the upper bound version of the model - where the impact of refinancing is to extend refinanced loans by 50% we estimate that 510,000 loans a year would be affected by the total cost cap. The majority of those - 490,000 are the result of refinancing.

In addition, the majority of loans affected in our model are longer term loans. Around 430,000 of the 540,000 loans affected by the price cap are the longest term loans offered by the big 4 home credit providers.

Our model relies on assumptions based on the best available evidence. The modelling approach is therefore inevitably crude. Modelling along the lines that the FCA was able to do for the payday loan cap would be needed to properly understand the impact of price caps in these markets.

The FCA should model the impact of a price cap based on accurate data showing at what stage during the original loans consumers are refinancing their home credit loans, and the terms upon which loans are refinanced.

Is there potential for unintended consequences?

Our modelling of the price cap assumes that all current loan contracts affected by the modelled caps are repriced down to the cap limit. In practice, market participants would respond to price caps in a range of ways, depending on suppliers' costs, customers credit ratings and customers' willingness to pay for example competitive responses.

A common argument against better regulation of payday lending - and against better protections for home credit consumers - is that it leads to unintended consequences. For example, in the high-cost short term credit market it was predicted that a price cap would leave vulnerable people with no access to credit and push borrowers into the hands of illegal lenders or 'loan sharks'.

However, the predicted unintended consequences of better protection for payday loan customers have been limited. The FCA found that the price cap resulted in consumers paying less for loans and being more able to repay them

on time.³¹ While the size of the market has reduced substantially, outcomes for consumers have improved.

There is also little evidence of negative impacts on customers whose application for a payday loan was turned down. For the majority of people who are declined when they apply for a payday loan, the impact on their finances is positive:³²

- **They are not pushed into further financial difficulty.** Nearly 2 in 5 (37%) say they took no action as a result. Only 1% said they missed a bill as a result and 63% said they thought it was for the best.
- **They are not pushed to other high-cost lenders.** The majority of people who are declined don't go on to borrow from other sources of high-cost credit. Only 15% did.
- **They do not borrow from illegal lenders or 'loan sharks'.** Our evidence, as well as that of the FCA, shows that there has not been an increase in problems with illegal lending. That is partly because people can still access credit and partly because loan sharks aren't a substitute for legal credit. The FCA found 'no robust evidence of declined applicants increasingly turning to illegal money lenders.'

³¹ [FCA \(2017\) High-cost credit: Feedback statement](#)

³² [FCA \(2016\) High-Cost Credit: Call for input](#)

Conclusion

Home credit is one of the largest high-cost credit markets in the UK. It is also the form of high-cost credit used most commonly by clients who come to us for help with their debts.

Our analysis shows that people struggling with home credit debts are particularly likely to be in vulnerable circumstances. Our clients are typically on low incomes, female, out of work, and living in social housing. Nearly half (48%) have a long-term health condition or disability, compared with 18% of adults in England and Wales, and they are half as likely to be in employment.

Home credit loans are typically repaid in weekly or fortnightly cash payments made to a lending agent who visits customers at their home. While home credit customers generally value the convenience that this model provides, it also gives rise to particular concerns about lending practices. Our research shows that unaffordable lending, plus the structure of the product which encourages people to take on multiple loans or to refinance their existing loans, is pushing people into financial difficulty.

For this report, we commissioned modelling to investigate the impact that a total cost cap similar to that introduced for payday loans would have on existing home credit loans. Our model suggests that, were existing loans to be priced down to the limits set by the cap, it could save consumers up to £123 million.

We're calling on the Financial Conduct Authority (FCA) to extend its definition of high-cost short-term credit to include home credit loans.

The FCA's regulation of payday lending has been one of its big successes - consumers are paying less for loans and more are able to repay on time. Removing the exclusion which omits home credit from these regulations would provide valuable consumer protections to home credit users, by:

- Limiting the number of times each loan can be refinanced
- Ensuring consumers never pay back more than twice what they borrowed

The FCA should build on our modelling by consulting on the possible impact of extending the definition of high-cost short-term credit to home credit loans. In that consultation they should collect evidence to test the assumptions in our model based on information held by lenders.

Appendix 1 - Methodology

This report uses two main sources of data - Citizens Advice client data and quantitative analysis modelling the impact of a total cost cap on existing home credit loans.

Citizens Advice client data

Citizens Advice records extensive information of advice trends provided to its face-to-face debt clients. This includes demographic information and advice trend data.

Data on the value of home credit and other debts, income, and demographics of clients with home credit debts was gathered using debt recording tools, typically only used during specialist debt advice sessions. Not all clients progress to this level of advice. The data used in this report therefore cannot be generalised to all Citizens Advice debt clients, though it provides insight into those clients who are struggling with home credit debts.

Finally, advisers are able to submit case notes for study where they believe a case demonstrates a particular policy issue worthy of consideration by our researchers.

Price cap modelling

Citizens Advice commissioned Lucerna Partners to develop a model to help us explore the impact of a total cost cap on existing home credit loans, similar to that introduced for high-cost short-term credit.

The price cap is made up of three parts. The model looks at the impact of the two that would have an impact in the home credit market:

- The cost cap of 100% which means that customers cannot repay more than the amount they originally borrowed in interest and charges
- The initial cost cap which limits the interest charged to a maximum of 0.8% per day.

We have not had access to the kinds of industry and customer data that FCA was able to use to model the impact of the payday loan cap. For example, we lacked data on the distribution between consumers of different loan characteristics – including loan lengths, APRs, and presence and scale of refinancing or late fees.

To attempt to address this problem, the model divides each market into 'parts' each with different loan characteristics. We make reasonable ranges of assumptions about the characteristics of, and proportion of loans in, each part of the market.

The approach to estimating the savings from applying price caps is also highly stylized. For example, we chose to construct a model which assumes all current loan contracts affected by the modelled caps repriced down to the cap. In practice market participants would respond to price caps in a range of ways, depending for example on suppliers' costs, customer credit ratings, customers' willingness to pay, and competitive responses.

This modelling approach is therefore inevitably crude. Modelling along the lines that the FCA was able to do for the payday loan cap would be needed to properly understand the impact of price caps in these markets.

Our model assumes:

- 1.7 million originations per year. We split those by customer market share of the four largest providers.³³
- An average loan size of £650. The mean size of a loan in 2016 was £770.³⁴ This figure includes refinancing of existing loans. We assume that 35% of loans contain an average of 50% refinancing, so that the mean size of new loans (i.e. not refinanced lending) is around £650.
- 10% of people have the shortest loan available for each provider, 40% of people have an intermediate length loan and 50% the longest loan. The lengths vary depending on the providers. The weighted average loan length is 39 weeks.³⁵
- 30% of short loans are refinanced, 40% of intermediate length loans, and 50% of long loans at each provider. That gives a weighted average of 44% of all loans.³⁶
- The majority (75%) of loans are on the representative APR at each lender. 20% have an APR which is 25% higher than advertised and 5% have an

³³ Customer numbers for the four largest providers were gathered from annual reports and websites in 2017. Number of annual originations is derived from Credit Reference Agency data published in [FCA \(2017\) High-Cost Credit Review Technical Annex 1](#)

³⁴ [FCA \(2017\) High-Cost Credit Review Technical Annex 1](#)

³⁵ [Competition Commission \(2006\) Home credit market investigation](#) found that the average term for a home credit loan was 43 weeks.

³⁶ Previous research has found that between 30% and 40% of new home credit loans are used to refinance an existing loan. [University of Bristol \(2013\) The impact on business and consumers of a cap on the total cost of credit](#); [CMA \(2006\) "Home credit market investigation", Final report.](#)

APR 50% higher than advertised. We also ran our model, to give low estimates, based on every loan being with the representative APR.

- The impact of refinancing was to increase the length of refinanced loans by between 30% and 50% at each loan length. 30% is used for the lower bound estimates and 50% for upper bound.

The final two assumptions are used to give upper and lower bound estimates in the model. The impact of those changes is shown in the table below:

| | All with representative APRs | | 75% with representative APRs | |
|--|------------------------------|-------------|------------------------------|-------------|
| | Loans affected | Money saved | Loans affected | Money saved |
| Low impact of refinancing (30% extension) | 411,000 | £43m | 466,000 | £59m |
| High impact of refinancing (50% extension) | 475,000 | £102m | 542,000 | £123m |

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Published March 2018

Citizens Advice is an operating name of The National Association of Citizens Advice Bureaux.

Registered charity number 279057.