FAIR BY DESIGN
Ending the extra costs of being poor

FINANCIAL CONDUCT AUTHORITY (FCA) INVITATION TO COMMENT: "CREDIT INFORMATION MARKET STUDY" (MS19/1.1) TERMS OF REFERENCE

JULY 2019

1. INTRODUCTION

1.1. Fair By Design welcomes the Financial Conduct Authority's invitation to comment on the "Credit Information Market Study" Terms Of Reference.

1.2. Please note that we consent to public disclosure of this response.

1.3. For more invitation about this response please contact Martin Coppack, m.coppack@barrowcadbury.org.uk Tel: 020 7632 9060.

2. ABOUT FAIR BY DESIGN

2.1. Fair by Design is a movement dedicated to reshaping essential services, like energy, finance and insurance, so they don't cost more if you're poor.

2.2. People in poverty pay more for a range of products including energy, through standard variable tariffs; credit, through pay day loans; and insurance, through post codes considered higher risk. This is known as the Poverty Premium.

2.3. We collaborate with industry, government, and regulators to design out the Poverty Premium.

2.4. Our Venture Fund provides capital to help grow new and scalable ventures to innovate in the market.

2.5. Fair by Design was conceived by the Joseph Rowntree Foundation and Big Society Capital. The Campaign is led by the Barrow Cadbury Trust, and the Venture Fund is managed by Ascension Ventures.

RESPONSE TO FCA INVITATION TO COMMENT: "CREDIT INFORMATION MARKET STUDY" TERMS OF REFERENCE

1. **Do you agree with our description of the industry, the sources of data collected by CRAs, and the usage of that data?**
   1.1. Yes

2. **Do you consider that the scope is appropriate to assess whether the credit information market is working well?**
   2.1. Yes

3. **Do you consider that the credit information market is working well?**
   3.1. We feel there are still reasonable questions that need raising about how the market works, how consumers understand it and engage with it , to the degree that they can change things for themselves and therefore improve their own financial wellbeing.
   3.2. Recommendation: The FCA could consider whether there is sufficient **transparency** in how credit scores are calculated by agencies, including weightings for different data points. As Nikita Aggarwal highlights, this is particularly pertinent in light of the increase of new forms of financial and non-financial data[1] – so consumers have a clearer pathway to improving their score.
   3.3. Recommendation: Furthermore, the FCA could consider whether it is satisfied that credit score reports sufficiently indicate information that lenders actually rely upon, as well as knowing the relative weighting placed by lenders on different categories of data when making credit decisions. This is because GDPR stipulates that consumers are entitled to request 'meaningful information about the logic involved' in any decision taken using 'automated means.'[2]
   3.4. Recommendation: The FCA could consider if the process for **fixing errors** on a credit score is fit for purpose. At present, the onus is on the consumer to chase up the agency or creditor. This is despite the fact that an error is usually made when the credit provider does not give the agency full information, or there was an administrative error by the agency when recording a consumer's financial history. And if the error is on all three credit reports, the consumer will need to submit a separate request to each credit bureau involved.
   3.5. While it is possible to pay credit file correction companies to do this on your behalf, it can cost hundreds of pounds a year. For consumers on a low income, this can add to the Poverty Premium – the extra costs they already pay for essential products and services, such as energy, credit, and insurance.
   3.6. This can also put increased pressure on time poor-consumers. As Andrew Tyrie recognized, in his speech 'Is competition enough' at the Social Market Foundation,

[1] https://www.law.ox.ac.uk/business-law-blog/blog/2019/07/big-data-and-obsolescence-consumer-credit-reports
[2] https://www.law.ox.ac.uk/business-law-blog/blog/2019/07/big-data-and-obsolescence-consumer-credit-reports

all consumers, regardless of income, can be time-poor, and therefore vulnerable to paying more [3] – in this case, because of an inaccurate credit score that is difficult to correct.

3.7. On the other hand, taking the time to shop around for credit products can often incur a penalty, specifically to a credit score. For low income consumers in particular, concerns about negatively affecting their credit score are frequently cited as a reason for not applying for credit products, electing to 'protect' their score. However, this also prevents them from applying for credit to use responsibly, for example to smooth over an income shortage during the month.

3.8. Fair For You, launched 'Soft Check,' a means of checking eligibility for buying products that doesn't leave a mark on credit files[4], allowing consumers to break the cycle of a poor credit rating resulting in high cost borrowing

3.9. Furthermore, for low income consumers, we query whether it is sufficient that someone without previous credit contracts to their name should be viewed by lenders as more risky than people with a history.

3.10. Research by Aqua found that 'near-Prime' consumers (a term used by PwC to describe consumers with minor marks on their credit record, or possessing a 'thin' credit file) had either never missed a payment, or missed just 1 or 2 payments.[5]

3.11. Most consumers catch up and these missed payments would not have impacted on a business's bottom line. Often, payers would simply like the option of delaying a bill payment, usually for reasons as simple as matching bill dates up with payday. Other times people's situations may be changing – but in a manner that is predictable, for example, reduced working hours but increased costs during the summer holidays.

3.12. While these factors are outside of the remit of the CRAs, missed payments should not necessarily be treated with such caution. It certainly shouldn't result in an individual being able to access less affordable credit, which would be one more likely outcome of a lower credit score.

3.13. Open Banking data could offer an opportunity in determining income and expenditure, and provide a 'real time' picture when assessing creditworthiness.

3.14. For instance, fintech startup Tully uses Open Banking to gather data, and AI and machine learning to provide highly personalised debt advice. The same technology could be used to create a personalised income/outgoings map to include in an affordability score.

3.15. OpenWrks' 'OpenAffordability' uses real-time and historic customer bank account data to analyse the income and expenditure of customers to help lenders make affordability decisions.

3.16. **Recommendation:** As the risk modelling of CRAs is commercially sensitive and often private, the FCA should consider whether there could be leniency on consumers who miss payments through factors outside of their control, such as late payment of wages, or illness.

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[3] http://www.smf.co.uk/andrew-tyrie-keynote/
[4] https://www.linkedin.com/pulse/soft-v-hard-credit-searches-matters-angela-clements/
[5] https://newday.co.uk/media/32466/research-on-the-near-prime-credit-market.pdf

3.17. Failure to share data between agencies results in increased costs to lenders for obtaining a comprehensive picture of an applicant. This is particularly impactful on smaller, 'responsible' lenders who play a key role in financial inclusion, lending to consumers who would otherwise turn to high cost, short-term credit (HCSTC) – and pay a poverty premium.

3.18. The FCA could consider whether the lack of competition in the credit information market, means that CRAs have undue influence over consumers' reports.

4. Do you have any views on the themes or the questions we are planning on exploring?

4.1. Fair By Design conducted surveys of people on low incomes, regarding access to credit, and credit information.

4.2. How do consumers use credit information series?

4.3. To what extent do consumers understand credit information

4.3.1. When asked how easy they found it to check their credit score, one respondent said it was

- "Straight forward with Martin [Lewis] Money Saving Expert."

4.3.2. On whether they knew how to improve their credit score, a respondent said

- "No I have no idea as it seems very hard."

4.4. How does this impact their behavior?

4.4.1. When considering the impact of credit information on access to other financial services, and the impact of credit information on lending decisions:

- "In the past I've had to take out loans with The Provident as I had such a poor credit history."
- "I was advised to take a DRO in 2016 due to benefits being stopped and left with nothing to live on. Since then my credit score which was previously ok has took a big knock. I couldn't pay for a holiday in instalments as company did a credit check on me. I generally stay away from loans."
- "Due to a poor credit history from my marriage, I am now unable to get credit and have used payday loans to buy food shopping etc. and then paying it back at increased interest causes issues the next month."
- "I'm reliant on credit to spread the cost of certain things but due to a credit rating that isn't great I get stung with huge interest rates meaning I pay far more in the long term (54% interest rate is my current highest)."
- "I have very little access to credit. And my credit rating is low."

4.4.2. However, given the lack of certainty around credit scoring, an implication for consumer behaviour may be that they are overly negative about their prospects for accessing mainstream credit – and so do not apply.[6]

[6] https://www.responsible-credit.org.uk/wp-content/uploads/2016/03/Does-Increased-Credit-Data-Sharing-Benefit-Low-Income-Consumers-final.pdf

5. **Do you have any views on the future developments of the credit information market or any other key developments we should be aware of?**
   - **5.1.** Research by Experian found that in more than three-quarters of cases, tenants with no significant rental payment arrears saw their credit score improve after factoring in rental payments.
   - **5.2.** This has led to increased discussion about rental data in credit scores, as evidenced by Lord John Bird's Creditworthiness assessment Bill, as well as start-up Credit Ladder.
   - **5.3. Recommendation:** We feel that there is a need for more research/analysis on what impact rent data would have on low income consumers, as well as how good a predictor rent data is for a consumer's behaviour, specifically when taking on a credit contract**.**
   - **5.4.** Rent payment can be considered a 'priority' payment (along with mortgage payments; energy bills and council tax) and so may not tell prospective creditors quite as much as the treatment of non-priority payments such as credit card debts or rent-to-own agreements or payday and unsecured loans.
   - **5.5.** While companies such as Experian say rent data will improve many people's scores, there is less information available on why this is the case, and why lenders should trust this, as well as what weighting this data would actually have.
   - **5.6.** CRAs' scoring models must consider the impact on (from Experian's research) the 8% of households who were in rental arrears, and the 15% who saw a decrease in the credit score.
   - **5.7.** For households already struggling, a negative change in their credit score – and in their ability to access affordable credit – could result in greater likelihood of paying a Poverty Premium, as they are excluded from the mainstream credit market.
   - **5.8.** This is particularly concerning when external changes in the environment, such as the roll-out of Universal Credit or cutting of council tax support, or private landlords increasing rent, will likely lead to an increase in arrears.
   - **5.9. Recommendation:** With the majority of low income consumers renting their homes, as well as the rise of 'Generation Rent,' the FCA could consider how frequent changes of address are factored into agencies' algorithms.
   - **5.10.** Non-financial, unstructured data, such as that scraped from social media accounts, is increasingly being used to better understand consumer trends and behaviour, in order to tailor products and services, as well as determine creditworthiness. This is both information offered up voluntarily e.g. on social media profiles – relationship status; education – but also 'leaky' data such as the browser or device used to access the website.[7]
   - **5.11.** If consumers knew this data was accessible by other firms making decisions about them then they would perhaps behave differently online. More so if they knew how being member of certain groups (on Facebook, for example) impacted their credit score. The fact is they aren't aware of this. That's because we lack knowledge of who is using what and how (e.g. what weighting data points are given

[7] http://www.charisma-network.net/finance/leaky-data-how-wonga-makes-lending-decisions

by CRAs). On that basis, given how at a disadvantage consumers are to aspects of their credit score, there is poor market information – which means consumers are, structurally, out of control.

5.12. **Recommendation:** The FCA should create a standard on how non-financial data can be used in credit information and scoring reports. This would ensure the FCA is on the front foot in the future, when lenders are relying on many more, and much more complex, types of data that often have a much less apparent relationship with creditworthiness.

5.13. The Consumer Financial Protection Bureau in the USA issued a request for information on the use of alternative data in credit scoring [8] **-** The FCA could issue a similar consultation.

6. Are there any other potential issues we should consider in the course of the market study which are not here?

6.1. In relation to Experian's study on rental data inclusion in credit scoring, further (publically available) evidence is needed to determine the impact of an improved credit score on their ability to access credit: the causal links, and how this information can be useful for consumers seeking to improve their score.

6.2. The supply of, and access to affordable credit sources, and/or finance initiatives that help people to avoid consumer credit e.g. Request To Pay, Rentflex, must be increased.

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[8] https://www.federalregister.gov/documents/2017/02/21/2017-03361/request-for-information-regarding-use-of-alternative-data-and-modeling-techniques-in-the-credit