Life on credit: the new normal

GK

onefourzero

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Foreword

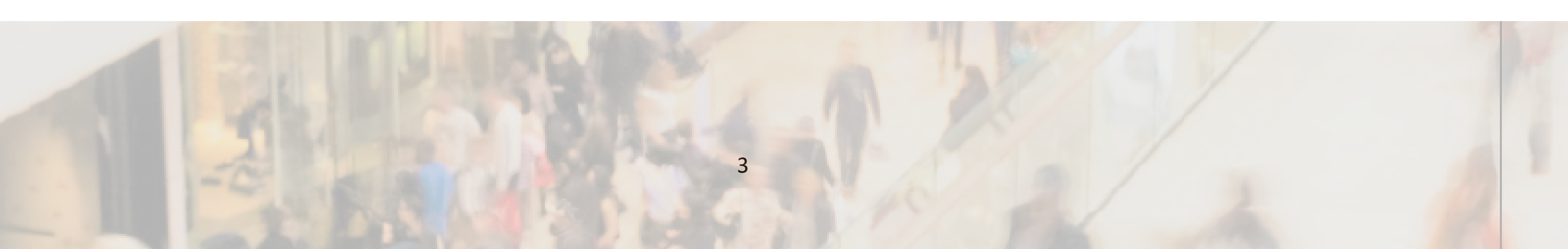
The world is changing – Robin Grainger, Group CEO GK and onefourzero

Consumer credit has become the new normal and British consumers are borrowing more than ever before. GK and onefourzero's latest report reveals that in 2017, as the cost of living rose and real wages fell for the ninth year running, consumers responded by increasing their borrowing through credit cards and overdrafts to maintain spending levels.

In response to increased demand, regulatory and policy attention is likely to fall upon credit card and overdraft providers, as well as other providers of credit. Investors and businesses operating in these sectors need to recognise the new risks and opportunities.

While the dangers of over-lending to vulnerable customers are well-documented, denying credit to those in a precarious financial situation could have serious social consequences; including increased reliance on foodbanks, extreme poverty and deprivation, or a rise in homelessness. Providers, policymakers and regulators must strike a fine balance between protecting consumers from falling into a cycle of debt and arrears, while ensuring that those who really need it can access credit.

Our new analysis explores the significant growth in consumer credit and asks: what does the normalisation of credit mean for the health of consumers and the economy? Is consumer credit a dangerous bubble waiting to burst, or a vital and increasingly sophisticated market that is adapting to meet growing and complex consumer needs?



Key Findings

GK and onefourzero analysed online consumer demand for credit cards and ovedrafts, the two fastest growing areas of consumer credit. Our analysis reveals:

Despite a slowdown in consumer credit growth overall, demand for overdrafts is increasing rapidly, with 23% year-on-year growth in 2017. There was a huge spike in demand for overdrafts in November 2017, with a 46% increase in demand compared to November 2016.

Demand for types of credit vary dramatically by region. Demand for credit cards is heavily concentrated in the South East of England, whereas overdrafts are most in demand in the North of England.

Demand for credit cards shows significant seasonal variation, with marked increases in demand in January (20%) and July (10%), indicating that consumers are using credit as they struggle to finance seasonal expenses.

Consumer credit is entering the mainstream: consumers are using credit to supplement the rising costs of living, rather than using credit as a last resort.

Increased consumer demand and regulatory interest provides an opportunity for new products and services which offer better rates for consumers, greater transparency and predictability and promote financial inclusion and good financial health.

Providers risk increased regulatory and political scrutiny as a result of increased demand, particularly over their lending policies towards vulnerable customers.

Wage stagnation, falling living standards and the evolving consumer credit market

British consumers are experiencing one of the longest periods of wage stagnation since the 1950s, with real wages falling for six consecutive months in the first half of 2017. Basic pay rose by just 2.2% in July-September 2017, behind inflation. Since the UK voted to leave the EU in June 2016, this gap has become even more pronounced as prices for everyday items such as food have risen by as much as 8%, driven by economic uncertainty and the falling value of the pound.

Meanwhile, unemployment continues to fall. The UK unemployment rate has fallen to 4.6%, its lowest since 1975. Much of this growth in employment has been fuelled by the rise of short-term contracts, freelancers and zero-hours contracts, otherwise known as the “gig economy.” The number of gig economy workers has grown by 76% since 2010, and around 5 million people in the UK were employed in this sector in 2017. Gig economy workers are paid based on the work they complete, providing increased flexibility but resulting in an irregular and unstable income. The complex tax situation for many self-employed people also makes financial planning difficult.

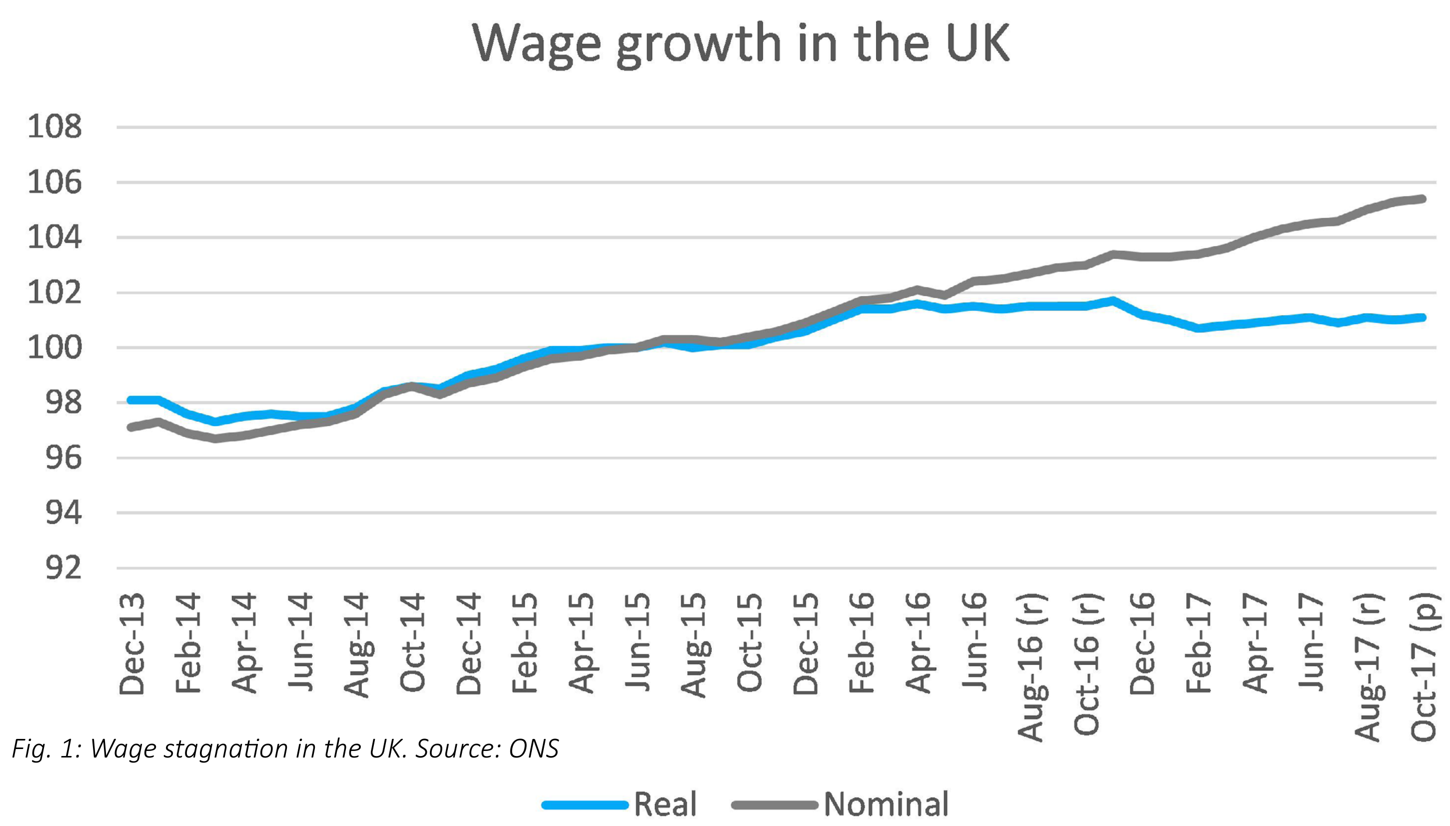
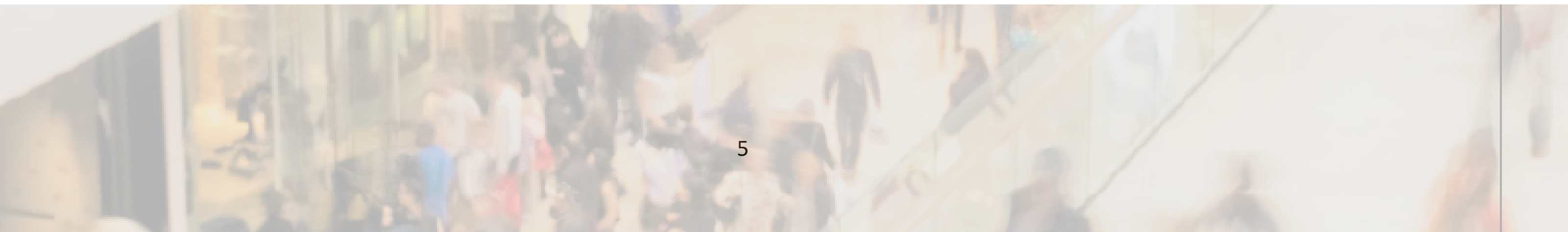


Fig. 1: Wage stagnation in the UK. Source: ONS



Wage stagnation and instability has also affected the ability of UK households to save. 16 million working age people in the UK have less than £100 in savings and in some areas of the country (Northern Ireland, the West Midlands, Yorkshire, the North East and Wales) half of the working population have savings of £100 or less.

Under these circumstances, consumer credit has grown rapidly since 2013. The value of the UK's debt exceeded £200 billion for the first time since the financial crisis in 2017, as employment increasingly fails to provide adequate financial security. Average consumer debt in the UK is £8,000, and over half of UK adults currently hold outstanding personal debt. Unsecured debt, including credit cards, makes up £83 billion of this debt.

Consumer credit in the UK takes many forms. The market is made up of overdraft facilities and credit cards with major established banks, as well as store cards, high-cost short-term credit (HCSTC), home-collected credit, rent-to-own agreements and credit unions.

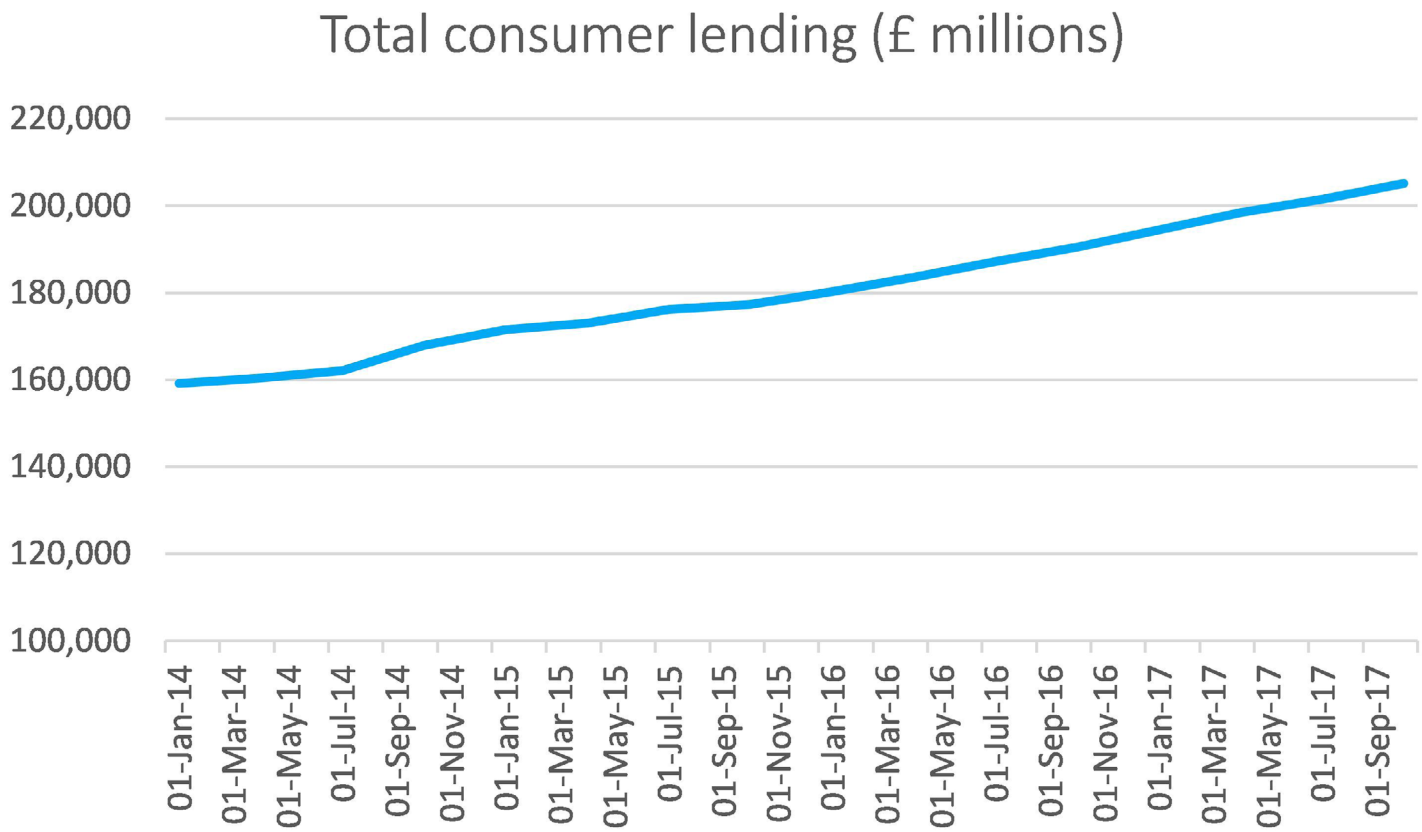
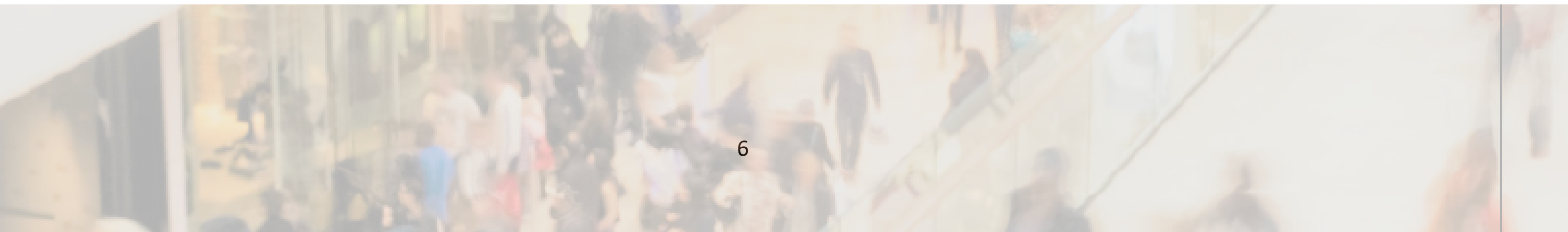


Fig. 2: Source: Bank of England

GK and 140 analysed demand data for credit cards and overdrafts (the fastest-growing areas of consumer credit) to better understand consumer borrowing habits and establish whether credit is becoming the new normal.



In Focus: Credit Card and Overdraft Demand

We assessed consumer demand through analysing search volume for queries relating to all forms of overdraft and credit card products from the last four years (December 2013 – November 2017.) Through examining seasonal and regional variation we were able to analyse who is using credit and why.

Despite Bank of England figures indicating that consumer credit growth overall had slowed to an 18 month low in November 2017, we found that overdraft and credit card growth is actually accelerating, with demand for overdraft facilities growing faster than any other form of consumer credit.

As illustrated in figures 3 and 4, overdraft demand grew in 2017 by 23% and 2016 saw year-on-year growth of 19%.

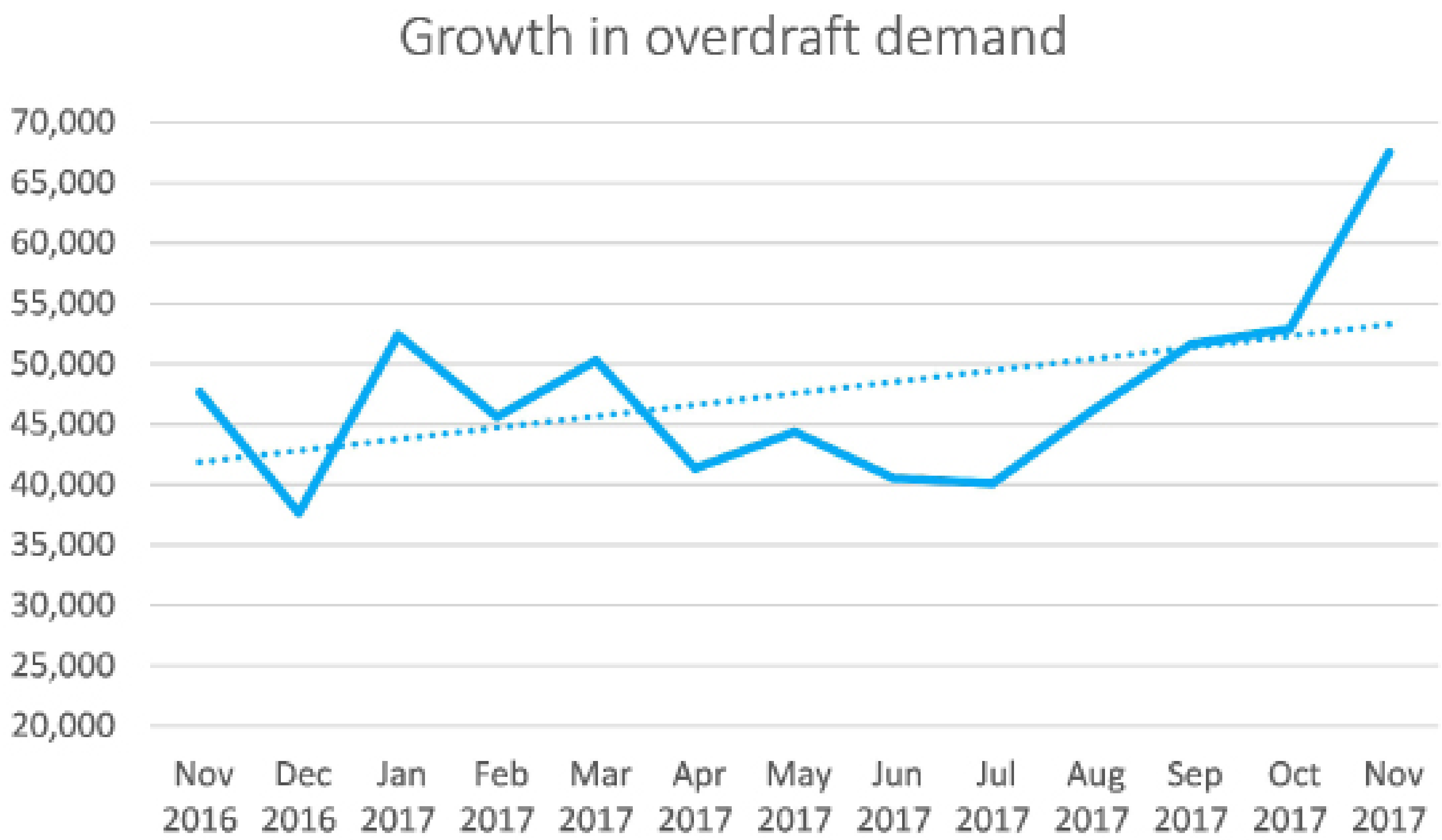
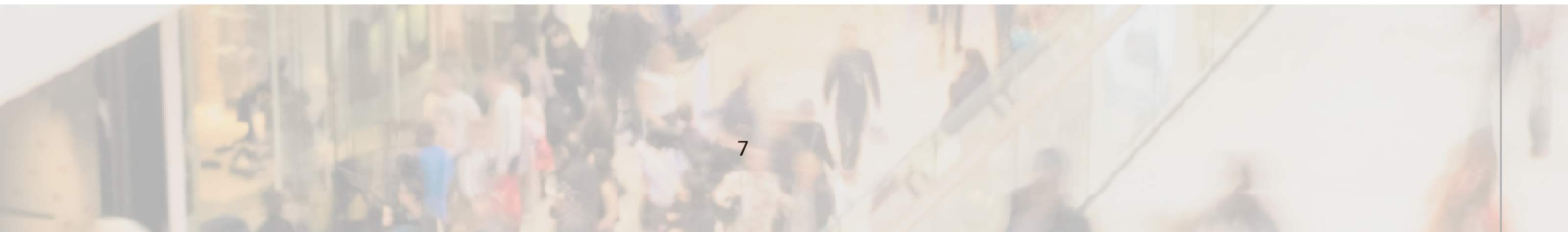


Fig. 3. Source: Google AdWords



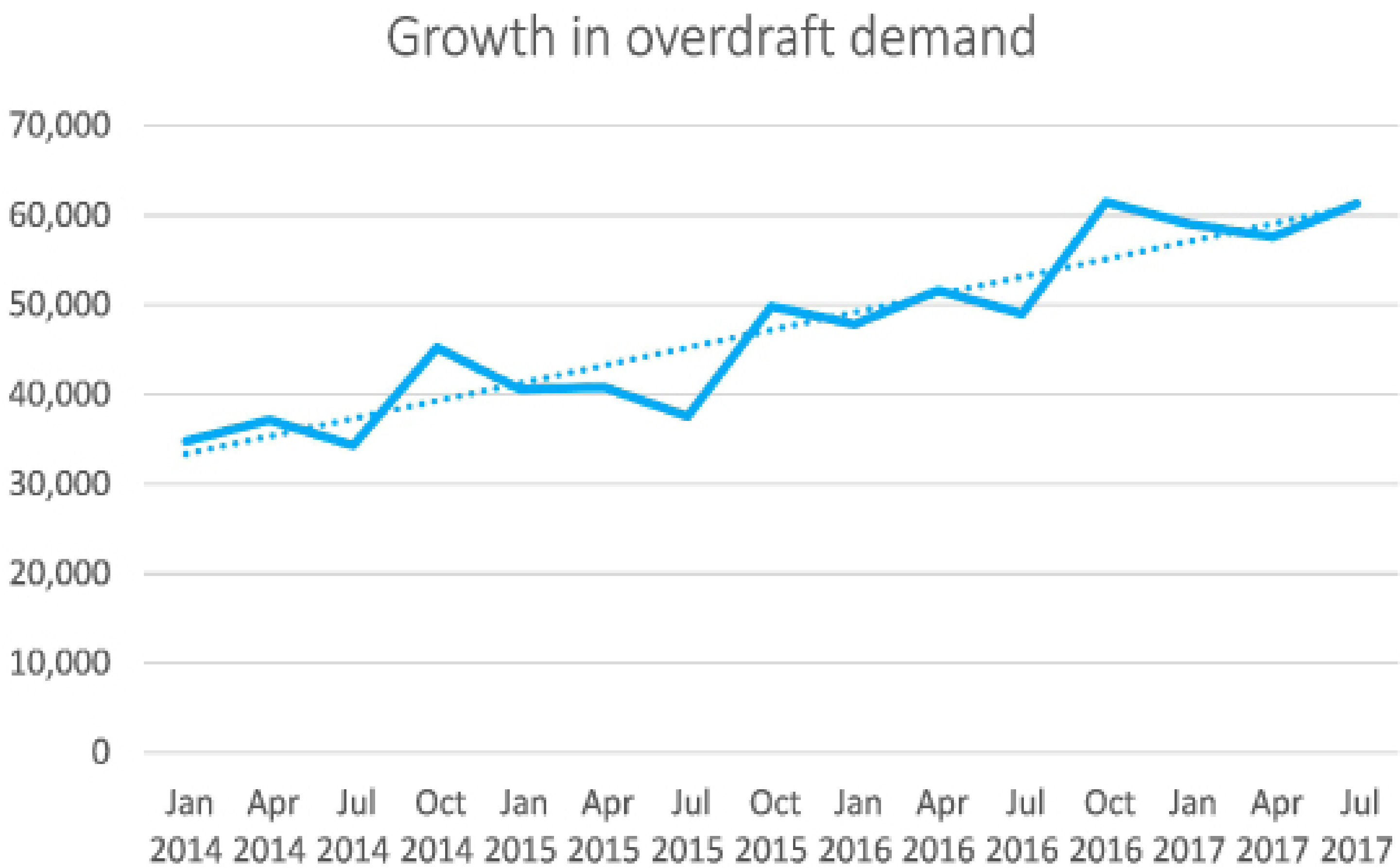


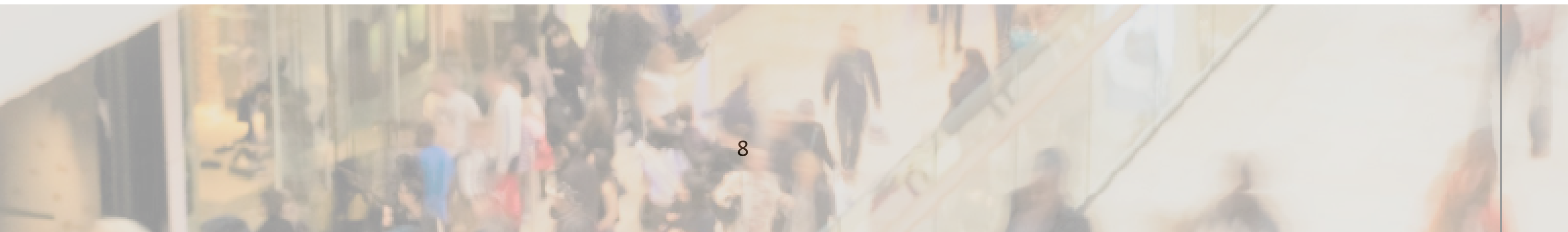
Fig. 4: Source: Google AdWords

onefourzero data also reveals a huge spike in overdraft demand towards the end of 2017, with a 46% increase in demand in November 2017 compared to November 2016. Consumers experienced huge price hikes during Christmas 2017, with a Christmas dinner costing on average 18% more than in 2016. The coinciding spike in overdraft demands suggests that with no increase in real wages, consumers are using their overdrafts to pick up the slack.

The rise in demand for overdrafts coincides with the rise of the gig economy in the UK and likely signals workers with irregular incomes using their overdraft facility to supplement their income to pay for monthly expenses. Overdraft demand growth rates increased from 2015, at the same time that real wages flat-lined, as seen in figure 1.

When analysing consumer demand for credit cards, we found that demand for credit cards is growing, though at a slower rate than overdrafts. Demand for credit cards saw a 5% year-on-year growth in 2017 compared with 2016.

However, credit card demand data shows much stronger seasonal variation, with pronounced spikes in demand every January, as seen in figure 5.



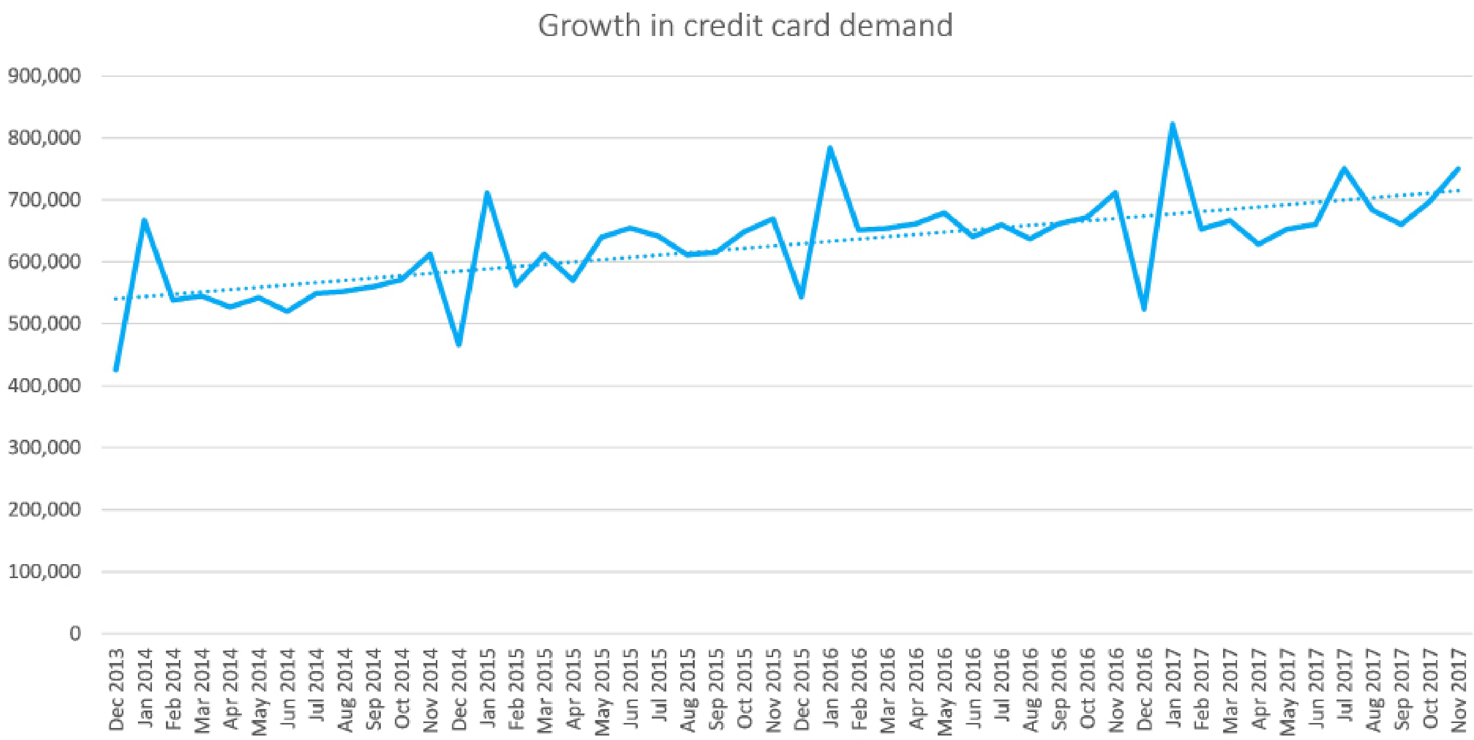


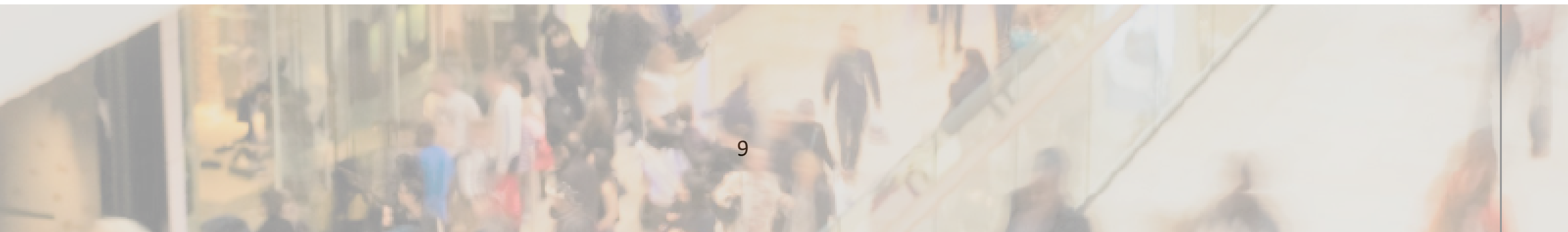
Fig. 5: Source: Google AdWords

Fleur Hicks - Managing Director

onefourzero's new data shows that overdraft demand is flying in the face of the consumer credit growth slowdown, with 23% year on year growth.

Our figures indicate a shift in consumer preference from payday loan providers towards more traditional forms of borrowing. This behavioural change is hardly surprising given that real wages have shrunk and prices have risen since the Brexit vote.

The question is how long the market can sustain this level of borrowing. Overdraft providers should be prepared for volatile consumer attitudes, particularly over issues such as interest fees, which can have a dramatic effect on consumer sentiment. Utilising big data and sentiment analysis can help organisations understand their customer, and build trust and market value.



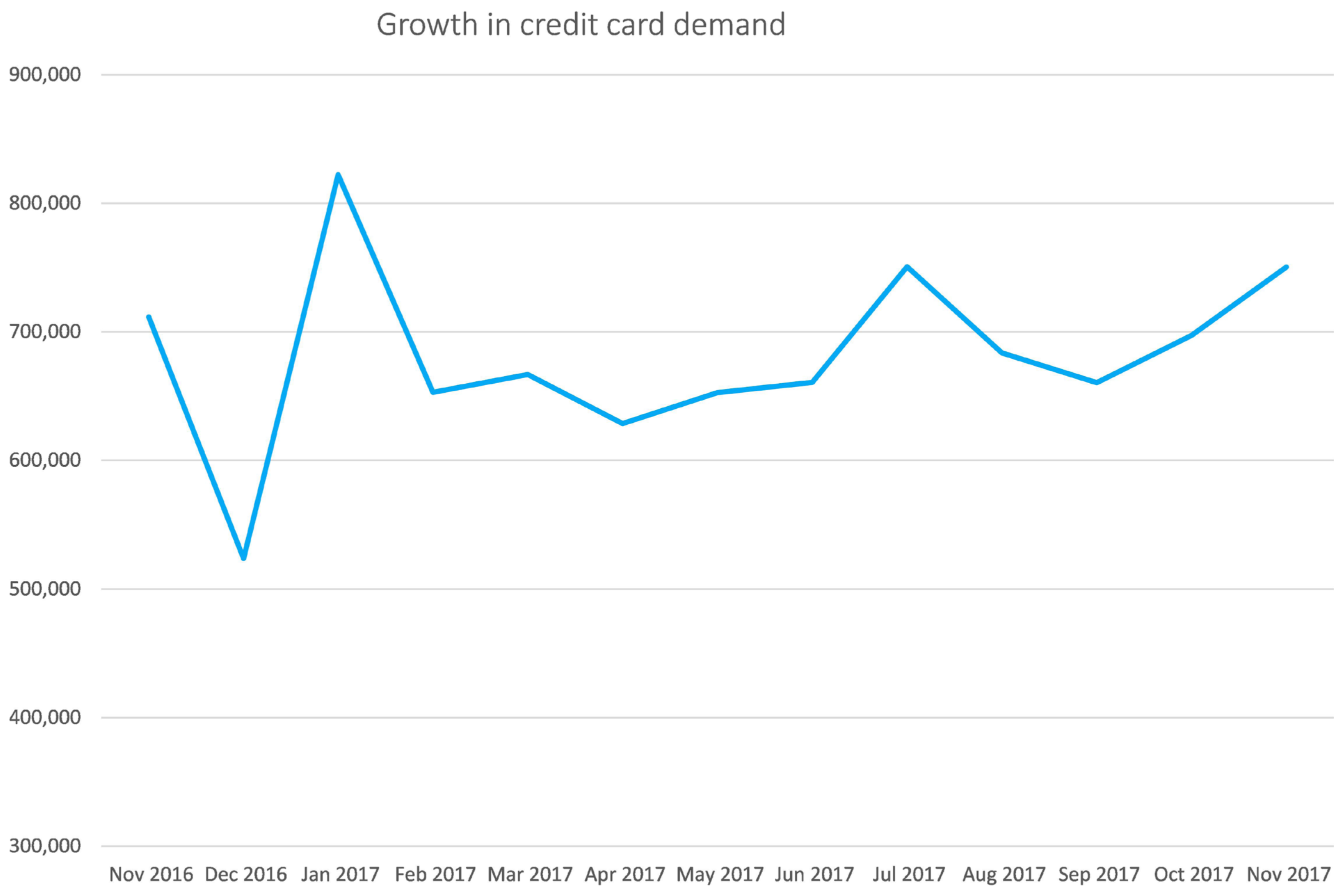


Fig. 6: Source: Google AdWords

When examining credit card demand over the last 12 months the seasonal variation is extremely pronounced, as seen in figure 6. We see a sharp rise in searches in January 2017 (20% above the average annual rate) and another smaller spike in July of 10%. The spike in January is likely to be due to festive spending and the spike in July could indicate consumers are using credit to finance holidays.

These figures suggest consumers are habitually (as seen in figure 5) using credit cards to finance expensive times of year, rather than for unforeseen or unexpected expenses which are not seasonal in nature. The latest retail figures show that while consumers are using credit more, they are not spending more; major retailers such as Debenhams, M&S and House of Fraser reported gloomy sales figures for Christmas 2017. Credit is simply being used to make up the shortfall and maintain spending levels as wages stagnate for the ninth year in a row.

The rise of the subscription economy could also help us to understand why credit use is up while retail spending is down. 90% of UK consumers now subscribe to products and services and the average UK monthly spend in the UK was £56 compared to £18.49 in 2016. Subscription services are attractive to cash-strapped consumers due to lower upfront costs, but customers end up with much higher monthly costs which could be driving credit card and overdraft usage.

By contrast, demand for so-called payday loan providers (higher-cost, short term loans that are more often used as a last resort) has fallen by 2% in 2017, as seen in figure 7. This trend away from specialist short-term providers towards mainstream methods of borrowing further supports the theory that consumer credit is entering the mainstream. The documented slowdown in consumer credit growth overall may have been driven in part by consumers avoiding payday loan providers.

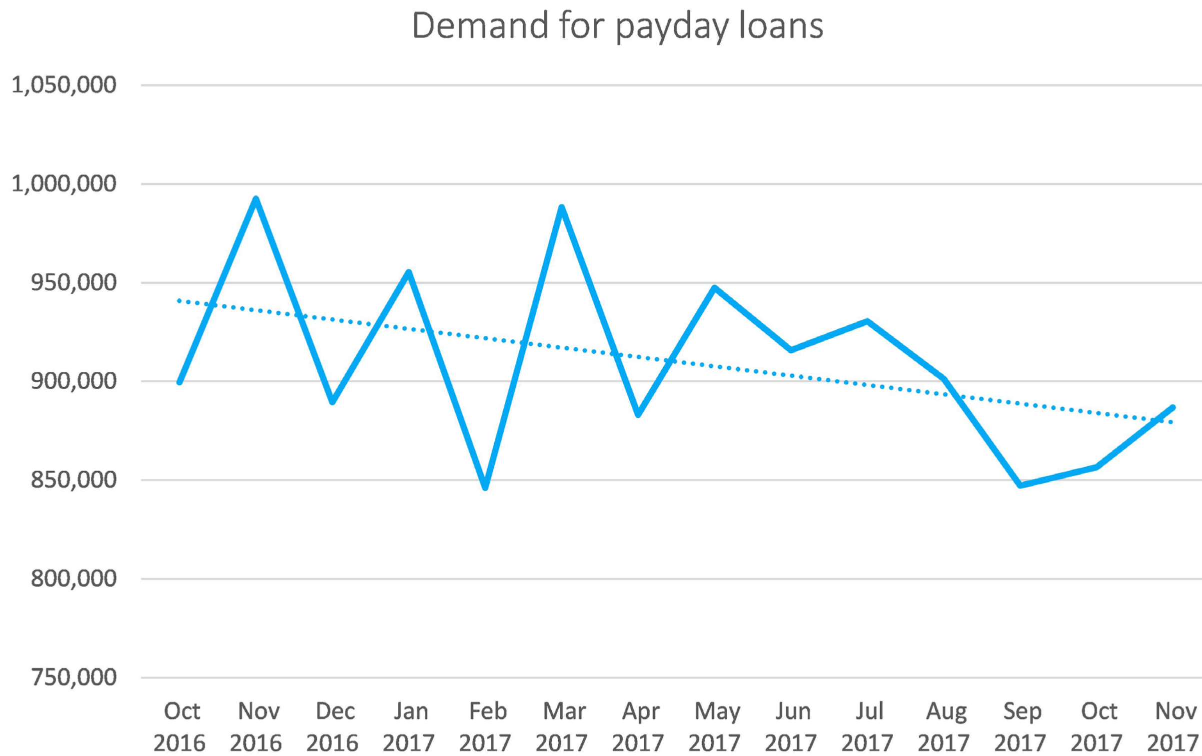


Fig. 7: Source: Google AdWords

Our findings are in line with the latest data from the FCA and the Bank of England , which show that growth in consumer debt is predominantly fuelled by borrowers with stronger than average credit ratings (usually the better-off), rather than extremely vulnerable "sub-prime" borrowers, who are usually the most vulnerable. Those with stronger ratings are more likely to be using credit to fund seasonal and day-to-day expenses, rather than accessing credit as a desperate measure.

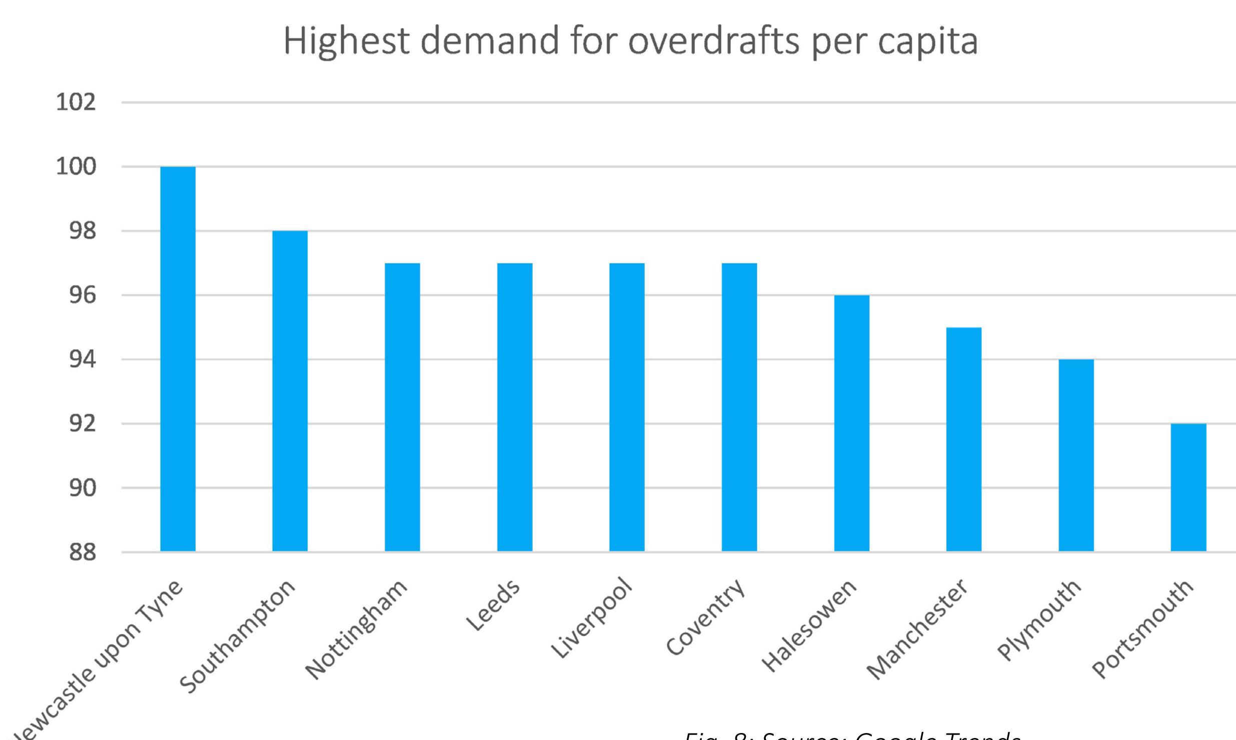


Fig. 8: Source: Google Trends

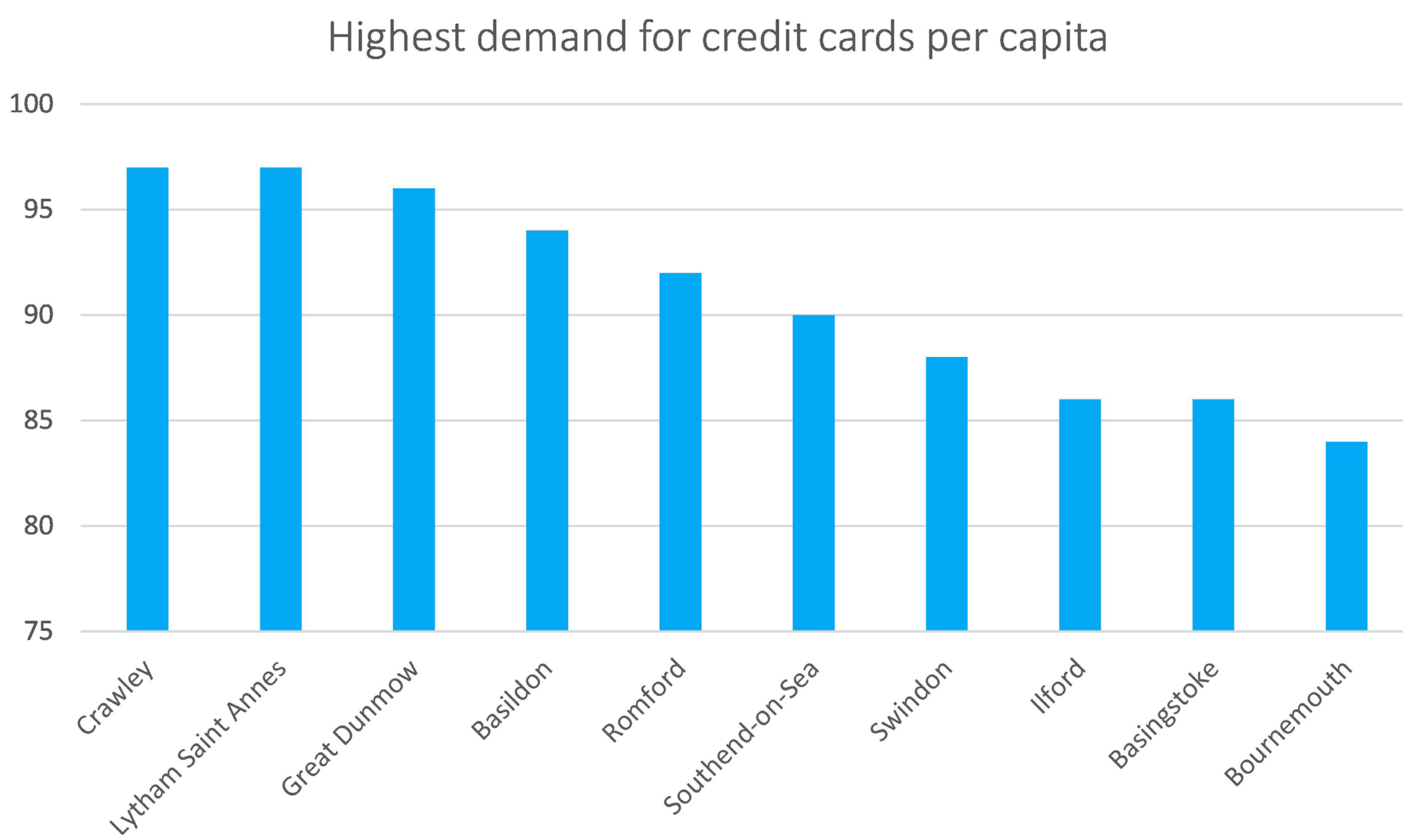
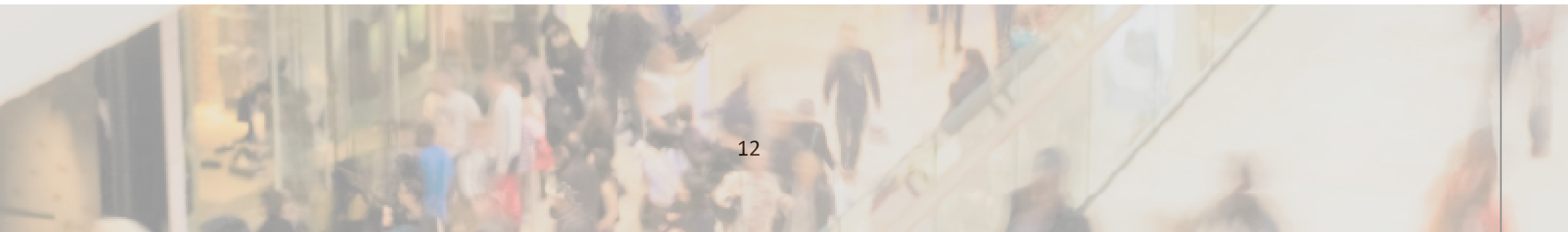


Fig. 9 Source: Google Trends

onefourzero used Google trends data to further asses the consumer credit market and found a strong regional disparity between credit card and overdraft demand. Overdraft demand is concentrated in the North of England and the Midlands, with Newcastle, Nottingham, Leeds and Liverpool among those with the highest demand. The unemployment rate for these areas on average is 5.6%, significantly above the national average of 4.6%. Newcastle and Liverpool have some of the highest unemployment rates in the country, at 7.1% and 6.8% respectively.

By contrast, demand for credit cards is heavily concentrated in the South East of England. Four of the 10 areas with highest demand (Basildon, Romford, Great Dunmow and Southend-on-Sea) are in the county of Essex alone and only one in the North of England (the upmarket seaside town of Lytham Saint Anne's in Lancashire.) Credit card demand is largely concentrated in affluent towns making up London's commuter belt and the South East of England.

This data highlights that despite a disparity in product choices, consumer credit use is distributed widely across the UK and is used by consumers across the income spectrum. This supports our conclusion that far from being a last resort, consumer credit has now entered the mainstream.



"Problem Debt" and Vulnerable Customers

Martin Summers
Head of ESG

This marked increase in credit has caught the attention of policymakers, financial institutions and debt management charities, many of whom are concerned about how long consumers can rely on credit to absorb the growing gap between wages and living standards. The issue of "problem debt", and its potential impact on the financial health of individuals and Britain's economy, is high on the agenda.

The Institute for Fiscal Studies defines households in "problem debt" as those with debt repayments that make up 25% or more of household income, those that are paying off debts to more than one provider, or those in debt for long periods of time.

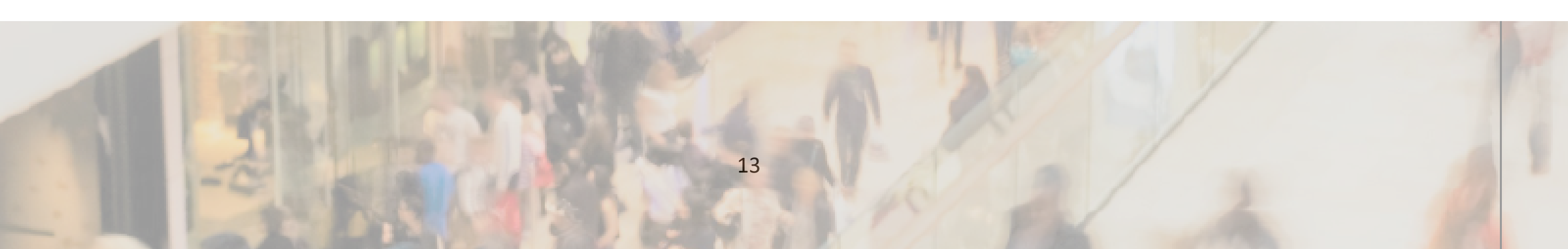
"Problem debt" has sparked the attention of the UK media, with stories focusing on high authorised overdraft fees of up to 52% APR and long-term credit card debt fuelling concern. In September 2017, the Bank of England warned that unsecured debt could cost the UK 30 billion as a result of over-indebted consumers defaulting on payments.

Concerns over the volume of consumer debt, particularly "problem debt", is driving much of the rapidly evolving regulation and policy in the consumer credit space. With credit becoming increasingly normalised and widespread, the challenge for policymakers and regulators is to distinguish between debt that is likely to cause problems for the customer and that which is harmless or even beneficial, and to act accordingly.

"Evaluating different financial options is often difficult, even if you're sufficiently financially literate to calculate the cumulative impact of compound interest or changes in your car's projected resale value. Making sound decisions is especially challenging when you're faced with misleading or confusing websites, subject to pressurised selling, or if you have an urgent need to fix, say, a broken down car or boiler.

Last year's FCA Financial Lives survey found that half of British adults display one or more characteristics that signal potential vulnerability, with 7.7 million adults over-indebted. The personal debt crisis and numerous financial mis-selling scandals has highlighted the need to understand and mitigate the factors that contribute to consumer vulnerability. Consumer vulnerability is no longer seen mainly as a matter of personal characteristics – age, mental health, disability – but also in terms of circumstance that could affect anyone: bereavement, divorce, redundancy, etc. This has now extended to periods of life, with the Bank of England issuing warnings of an impending consumer credit crisis as over a quarter of young people are constantly in debt.

Financial service providers have understandably become very compliance-driven as a result of FCA rulings; devoting their resource and focus to compliance, often at the expense of trying to identify where they can build most value for their business and customers. Given the volume and breadth of people now using credit, policies and regulatory measures to protect consumers must now broaden in scope.



This can be through aligning with best practice, or indeed displaying market leadership, demonstrating to regulators, policy makers and the public that they understand vulnerability and are marketing and structuring their offer to consumers who may be vulnerable. The FCA has said that it expects "firms to frame decisions for consumers based on real world consumer behaviour and not to exploit biases." One example of bias they cite is the tendency to over-borrow and underpay, given that consumers perceive costs expressed in percentages to be lower than those expressed in absolute amounts.

Such an approach, going beyond existing compliance requirements, is all the more important given that the FCA recently said in its report FCA Mission: Our Future Approach to Consumers that it will make "sure we stay one step ahead and prepare for key shifts that increase the risk of consumer harm or affect how consumers engage with financial services." It has also made clear that it is open to solving problems in markets without formal interventions: "We have seen improvements in a number of areas following our other less prescriptive interventions, particularly firms' consideration of access, vulnerability and an ageing population. We now need to consider whether we are striking an appropriate balance between formal interventions and use of our convening powers." Firms would be wise to see how they could work with their peers and the FCA to resolve and anticipate problems rather than simply comply and then wait for additional compliance requirements at a later date."

Regulatory and Policy Scrutiny

Consumer credit is already an area of intense policy and regulatory scrutiny and with overdraft and credit card borrowing becoming ever more widespread this scrutiny is set to increase.

The growing demand for overdrafts and credit cards has already provoked negative media coverage of high fees. Following successful legislation against payday loan companies, the FCA has turned its attention to overdraft and credit card providers. In November 2017, the Treasury Select Committee, chaired by Nicky Morgan, launched an inquiry into consumer debt aimed at investigating levels of debt and treatment of vulnerable customers by banks.

The inquiry is ongoing and still accepting evidence at the time of writing, but past incidents have highlighted how public and political pressure can prompt regulatory action. In 2016, former Labour Leader Ed Miliband joined a campaign against rent-to-own retailers and one provider was ordered by the FCA to pay £14.8 million to customers hit by high fees as a result. Similarly, in 2014 an FCA rulings over lending to sub-prime borrowers resulted in one payday loan provider having to pay back £220 million of loans to borrowers.

The FCA and politicians are now turning their attentions to credit cards and overdrafts. In July 2017, the FCA published the outcome of its review into consumer credit. The report noted the success of the existing payday loan cap and targeted overdraft providers, calling for "fundamental changes" to the way high cost overdrafts were provided and warning that "the status quo is not an option." The report signalled a continued scrutiny of high-cost credit, with a shift in focus towards traditional providers.

In December 2017, the FCA proposed new regulation on credit card fees with the objective that credit card providers offer more support to get customers out of debt, including repayment plans, early interventions and waiving debt. In January 2018, following an EU Directive, the Treasury banned companies from charging "rip off" surcharges on credit card purchases. This is reflective of a wider UK and international policy trajectory of greater consumer protection and support to effectively manage debt.

However, if a regulatory crackdown leads to vulnerable customers being denied credit, with no savings to rely on, this could have equally dangerous consequences. If customers cannot access credit to pay for unexpected costs or gaps in income, they will suffer a fall in living standards and those at the sharp end who rely on overdrafts and credit card borrowing for essential costs may be forced to rely on foodbanks, risk falling behind on rent or mortgage payments, or forgoing essentials such as heating and water.

Perspectives on the Political World

Jamie Cater
Senior Policy Analyst

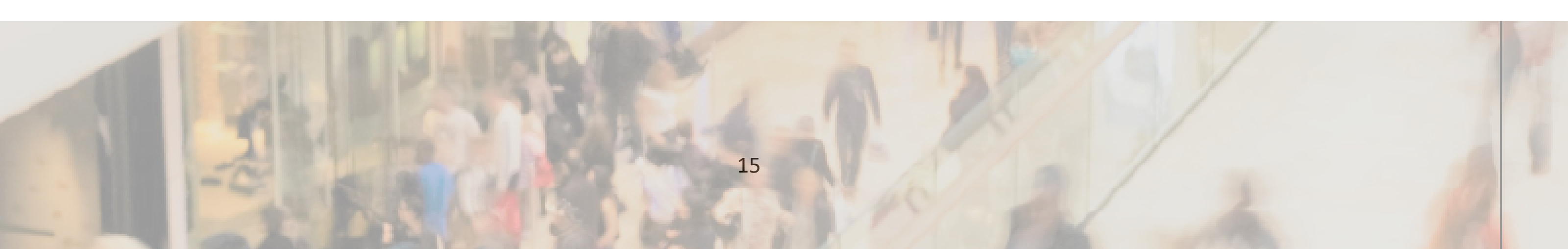
Since the 2008 financial crisis, policy and regulation in relation to consumer credit has evolved rapidly in response to both a changing political environment and the demands of consumers. The Government and the Financial Conduct Authority (FCA) have sought to balance their response in a way that addresses concerns about the treatment of vulnerable consumers, while ensuring that the sector operates healthily and responsibly.

In its early days the FCA was keen to be seen as an activist regulator, ruthlessly defending the interests of the consumer in a way that it felt its predecessor, the Office of Fair Trading, was unable to do effectively. Indeed, the FCA's approach to the payday lending sector was indicative of its eagerness to be a more proactive regulator; though for some of its detractors the FCA had shown itself to be too easily influenced by political headwinds in immediately addressing this market rather than other retail financial services that had also attracted criticism. It was evident that addressing the needs of consumers, particularly vulnerable consumers, to access credit would be a key part of its future strategy. Subsequent developments in regulatory policy and its areas of focus – credit cards and motor car financing, among others – have continued in this vein.

As for the Government, there is a political imperative to prioritise action in this sector. There are a number of causes of the general increase in demand for credit in the years since the financial crisis, such as the long-term decline in real wage growth and increasein self-employment and flexible working, which have made incomes more unpredictable.

Policy-makers are aware that access to finance provides legitimate help to consumers, but are also wary of both an economic recovery built on unsustainable levels of household debt and the political risk of individual households struggling to repay debt they have taken on in the context of structural economic change.

Both the Government and the regulator are feeling their way towards promoting a sustainable consumer credit sector that is seen to provide both adequate access and protection to vulnerable consumers. Legislation over recent years, such as the Consumer Rights Act 2014, has shown that policy-makers are keen to arrive at solutions that actively defend the consumer interest without detracting from businesses offering products and services for which there is a clear demand. Negotiating regulation in an increasingly politically-sensitive sector is likely to be a challenge for both business and government over the coming years, and operators and investors need to manage this risk effectively.



Promoting financial health, literacy and inclusion has therefore been increasingly high on the policy agenda over the last two years. In 2015, the Financial Inclusion Commission was set up, indicating a renewed focus on ensuring those with low incomes can access credit fairly. In June 2017 the Government also appointed the first minister for Pensions and Financial Inclusion, Guy Opperman.

In January 2018, the London Assembly Economy Committee published a report on the financial health of Londoners, calling on the Mayor to develop financial inclusion strategies, promote healthy credit, explore how community banks and credit unions could be supported to provide products and services and convene a summit with industry leads, fin-tech providers and not-profits to explore new ideas and areas for innovation. This desire for collaborative action to provide a safer way of providing credit displays an understanding from policymakers of the need for inclusive consumer credit providers.

A focus on ensuring financial inclusion and good financial education is essential if credit is to continue to be a part of everyday life. This will ensure that customers are able to make informed decisions and avoid falling into problematic debt.

In an environment of intense public, political and regulatory scrutiny, credit providers must strike a difficult balance. To avoid being on the sharp end of regulatory change, overdraft and credit card providers should ensure they have robust policies in place for fees and subprime lenders, and should provide excellent debt management support to customers at risk of "problem debt." On the other hand, providers also face growing political pressure to ensure they are financially inclusive, promote financial health and literacy, and meet vulnerable customers' needs.

An Opportunity for Challenger Brands

The normalisation of credit, combined with attention from policymakers, media and regulators, provides an excellent opportunity for new credit providers to enter the market.
An opportunity exists for products and services that provide fair deals for consumers and that offer credit while improving the financial health of consumers.

A market already exists for credit cards that improve users' credit ratings from companies such as Marbles and Vanquis. Overseas, the alternative lending market is flourishing. 18 publicly owned banks currently operate and lend in France and in the USA credit unions own one trillion in assets. An increasing number of challenger banks and payment systems, such as Monzo, Cleo, and Emma, are using Artificial Intelligence and insights to help customers budget more effectively and manage debts. The recent Open Banking Initiative should encourage further innovation in this space.

Under the initiative, banks will have to share customer data with verified third parties. In practice, this is likely to make it easier for customers to choose many different providers, rather than having their data owned by one bank, and therefore to pick the best service for their needs. This should open up opportunities for new overdraft and credit card providers to target customers already using one bank. This new data source available could also be invaluable in helping new providers to tailor new products to current borrowing habits.

Any new provider of consumer credit facilities should ensure they go beyond compliance and demonstrate excellent practices to ensure and promote the financial health of their customers. Customers will no doubt want to be confident their data is handled and used securely, and for any new credit provider building trust amongst consumers is essential. Good relationships with regulators and politicians is also key to building market value in a fast-changing and highly regulated sector.

Conclusion

It is clear from our unique data insights that consumer credit has become the norm. What was once seen as a last resort used by individuals in dire financial straits is now a feature of everyday life; as more consumers rely on credit to maintain spending. Credit card and overdraft use is widespread across the country and growth rates are increasing year on year. British consumers are now used to relying on credit as a method of funding their day-to-day lives and seasonal expenses, as wages and savings struggle to meet increasing living costs.

The normalisation of credit poses difficult questions for providers, policymakers and regulators. With more people borrowing than ever before, it becomes more difficult to distinguish between problem debt, and that which is necessary.

The Government's recent ban on credit card fees and Shadow Chancellor, John McDonnell's proposed "total cost cap" on credit card loans indicate that both the Conservative and Labour Party's approach to consumer credit so far has been to ban or limit the power of providers. However, policy and regulation that merely aims to limit the power of providers to lend is no longer sufficient. Instead, in an environment where consumer credit is the new normal, providers must proactively engage with regulators and policymakers, and cross-sector collaboration is needed to ensure the financial literacy and financial health of consumers.

Existing providers of consumer credit must ensure they horizon scan for risk, demonstrate they have outstanding Environmental, Social and Governance policies and processes to seriously address the issues of problem debt and vulnerability.

How Can GK Help?

- Strategy Development: As an integrated agency with consultants drawn from across the field of politics and communications, GK can help you shape, deliver and measure your engagement with key influencers and decision makers

- Policy Analysis: GK has a dedicated research team who specialise in delivering high quality poitical and policy analysis to inform your business or campaigning decisions

- Market Mapping: Audit of policy environment in your key markets, your current relationships and provide comprehensive lead sourcing of key decision makers to provide strategic plan for growth

- Message and Collateral Development: Ensure your sales and marketing messaging resonates with the policy priorities of the public sector and the individual procurement teams

- Business to Government (central and local) Sales Support: Stakeholder engagement strategy to support your sales and advice on how best to approach opportunities

- Market Shaping: Strategic engagement to shape the opportunities of tomorrow to best suit your products or services

- Profile Raising: Building brand recognition and understanding with key influencers and decision makers

- Opportunity Monitoring: Live tracking of key policy developments and opportunities that might arise for your business

About the Authors

Jamie Cater - Senior Policy Analyst

Jamie is GK Strategy's Research Manager, working on political due diligence, political risk analysis and opportunities profiling. He specialises in qualitative research on a range of public policy issues, including health and social care, financial services, energy, employment and education. Prior to joining GK's research team in 2014, Jamie worked in the offices of a former Shadow Education Minister and Shadow Transport Minister.

Fleur Hicks - Managing Director

Fleur is a strategic Marketing and Operations professional with over 16 years' experience managing blue chip digital and broadcast brands with 7 figure commercial success in the B2C and B2B2C sectors. With key experience across web, mobile, TV and print, Fleur has delivered industry-leading marketing and operations analysis strategy at board level in consultative and client side roles. Fleur joined the company in autumn 2015 and has overseen its growth from a two man consultancy to world leading Digital Diligence Agency. Fleur is also an elected fellow of the RSA and sits on IDM, IAB and WOMMA councils.

Martin Summers - Head of ESG

Martin has decades for experience advising on ESG (environmental, social & governance) and compliance work for the investment community and corporates. Martin has over 15 years' experience advising companies and investors on regulation, compliance and reputation management issues, including: advice to private equity and investment management firms on ESG, political and regulatory issues and communications to investors and portfolio companies.

Quincey Simargool - Junior Analyst

Quincy is a junior analyst with a consumer background with project experience projects spanning a variety of sectors. Having worked with a diverse range of clients from different industries, Quincy brings specific commercial relevance to data and insights. Prior experience in the technology sector further strengthens our team tech capability. Quincy graduated from the University of Dundee with an MA in Financial Economics.

Caitlin Wilkinson - Business Development Executive

Caitlin joined GK's marketing team in November 2017. Prior to joining GK, Caitlin worked in the corporate fundraising team at youth homelessness charity Centrepoint, and has previously worked in marketing in the not-for-profit sector. Caitlin graduated from the University of Bristol with a degree in History.

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