High-Cost Credit Review Technical Annex 1: Credit reference agency (CRA) data analysis of UK personal debt

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Contents

1 Key findings

This research analyses personal debt held by UK consumers using credit reference agency (CRA) data. Personal debt includes non-mortgage debt such as credit cards, personal loans, motor finance agreements and utility bill debt.

Our analysis focuses on six less mainstream credit products which typically have relatively high costs of borrowing. These are: catalogue credit, store cards, high-cost short-term credit (HCSTC), home-collected credit (commonly known as home credit), rent-to-own agreements and guarantor loans.

Part I of this document explains the main findings from this research. Part II analyses particular markets in greater detail. A brief summary of the findings are:

- Over half of UK adults hold outstanding personal debt. Over 30% of outstanding personal debt is held by 1.3 million people - 2.6% of UK adults.
- There is large variation in the sizes of less mainstream credit markets. Of these, catalogue credit is a lot larger than others by number of consumers.
- There are large differences in the arrears, default rates and repeated consumer use of different less mainstream credit markets.
- There are similarities in the distribution of credit scores of borrowers using less mainstream credit products. The exception to this is catalogue credit borrowers who, despite having noticeably better credit scores, have relatively high arrears and default rates on these products.
- A greater diversity in the socio-economic profile of people borrowing across less mainstream credit products is observed via measures other than credit scores. Rent-to-own borrowers have much lower incomes, higher debt-to-income (DTI) ratios and hold debt on more products than those using other less mainstream products. HSCTC borrowers are much younger than home credit borrowers.
- Across users of less mainstream products we observe a consistent pattern of their financial situation worsening over time. However, that it not to say it is the credit product itself which causes this deterioration. It is possible for consumers to recover from these positions – we observe former borrowers who are no longer using these products often having improved financial outcomes.
- The composition of debts varies considerably across people borrowing on different less mainstream credit products. Credit card and unsecured personal loans commonly account for a high proportion of personal debt. Home credit, guarantor loan and rent-to-own borrowers typically have the largest proportion of their outstanding debt on each of those products respectively. We observe that it is common for these individuals to have outstanding debt on household bills – though this accounts for a small proportion of their overall personal debt.

This analysis relies upon CRA data which have a variety of important limitations. These limitations include that the CRA data does not include all debts held by an individual as firms are not required to report this information. The stock of outstanding debt in the CRA data becomes less representative further back in time for a variety of reasons. For example, defaulted debt is removed from the CRA data six years after entering default. Incomes are estimated and not always based on verified information.

PART I: ANALYSIS OF UK PERSONAL DEBT

2 Research objectives and data description

Research purpose

2.1 UK consumers hold a broad array of credit products which are used by different groups of people, in different ways, for different purposes.[1] The high-cost credit review focuses upon a segment of the market which the FCA are particularly concerned with - credit products which have especially high costs of borrowing and are used by more vulnerable groups of consumers.[2]

2.2 This technical annex's primary purpose to inform the next phase of the high-cost credit review. It is also used to inform the FCA's understanding of personal debt (debt on products such as credit cards, personal loans, high-cost short-term credit loans and utility bills) more broadly. We publish this to help inform consumer organisations, market participants and other interested parties.

2.3 Consumers using high-cost credit products – a term which has no formal definition - may be considered vulnerable for a variety of reasons. For example, consumers may be high credit risks (i.e. unable to access cheaper sources of borrowing), have low or unstable incomes (i.e. vulnerable to shocks to their finances) or in financial distress (i.e. suffering financial or non-financial difficulties such as mental health issues from repaying debts).[3] Such vulnerabilities could potentially warrant greater consumer protections for consumers using high-cost credit than for those using other credit products.

2.4 Our methodology enables us to diagnose where there may potentially be the most harm to consumers – in terms of scale and severity – to inform future work. We sought to answer the following questions:

i. **Market size:** How large are the different high-cost credit product markets?

ii. **Credit performance:** What are the outcomes for consumers using different high-cost credit products?

iii. **Consumer circumstances:** What are the socio-economic circumstances of consumers using different high-cost credit products?

2.5 Mortgage debt is quite different from personal debt and is not the focus of this research given the detailed public information on this market and forthcoming interim report of the FCA mortgage market study.[4] When we examine the borrowers with personal debt we also examine whether they also have mortgage debt.

2.6 Chapter three of this document summarises the overall personal debt market and mainstream forms of credit - credit cards, arranged or unarranged overdrafts, motor finance agreements or unsecured personal loans. The majority of our analysis focuses on consumers using 'less mainstream' forms of credit products. Less mainstream credit products are defined here as those which are not credit cards,

[1] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-20.pdf

[2] https://www.fca.org.uk/publication/corporate/our-mission-2017.pdf

[3] https://www.fca.org.uk/publication/occasional-papers/occasional-paper-20.pdf

http://www.moneyandmentalhealth.org.uk/moneyonyourmind/

https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/money-worries-have-impact-on-physical-and-mental-health/

[4] Mortgages market study terms of reference

https://www.fca.org.uk/publication/market-studies/ms16-02-1.pdf arranged or unarranged overdrafts, motor finance agreements or unsecured personal loans.[5] It therefore includes products such as high-cost short-term credit (HCSTC) loans, catalogue credit, home credit and rent-to-own agreements. We focus on these less mainstream credit products because other, on-going FCA projects are examining mainstream credit markets in detail.[6] As debt products do not function in isolation our analysis of consumers with less mainstream credit products also considers their mainstream, less mainstream and utility bill debts.

Credit reference agency (CRA) data description

2.7 In order to answer the questions posed above we gathered representative samples of credit reference agency (CRA) data. These data enable us to look across the spectrum of products potentially considered to be high-cost and understand how they fit into consumers' personal debts - other debts on products including credit cards, personal loans, motor finance agreements, high-cost short-term credit loans.

2.8 The format of these data enables us to carry out detailed analysis at the product, firm or individual level. It also allows us to analyse how these have changed over time. At two points-in-time - January 2015 and January 2017 – we observe credit scores (measuring the risk of a consumer missing payments on credit agreements) and estimated incomes. As these income estimates are often not verified these are more usefully considered as indications of average income levels.

2.9 The main credit file portfolio dataset shows all of an individual's credit items reported to a CRA. A credit item could be a mortgage or a personal debt such as a credit card or utility contract. For each of these credit items we observe details of the type of product and origination information (e.g. origination date and amount) and up to 72 months of performance data (most notably outstanding balances and arrears statuses). There are strict reporting guidelines ensuring that firms submitting data to CRAs do so consistently.[7]

2.10 While these data are a representative sample of credit agreements reported in CRA data, it does not cover all credit agreements as firms are not required to report information to one (or more) CRAs.[8] We are aware that some motor finance and utility bill providers do not report in these data. Further back in time these data increasingly underestimate the amount of personal debt outstanding for a variety of reasons. More details of these data, caveats and data cleaning undertaken are in Appendix 1.

Structure of Technical Annex

2.11 Chapter three provides an overview of personal debts held by UK consumers. Chapter four provides a comparison of less mainstream credit products potentially considered as high-cost credit. Part II of this document - chapters five to eleven - analyse less mainstream credit products in greater detail.

[5] Credit cards, unsecured personal loans and motor finance agreements account for the majority of outstanding stock of personal debt. Overdrafts account for a much smaller proportion of outstanding stock of debt but are very commonly held by consumer.

[6] Motor finance exploratory work

https://www.fca.org.uk/publication/business-plans/business-plan-2017-18.pdf

Credit card market study final report

https://www.fca.org.uk/publication/market-studies/ms14-6-3-credit-card-market-study-final-findings-report.pdf

FCA response to CMA retail banking investigation final report

https://www.fca.org.uk/publication/corporate/response-cma-final-report-competition-retail-banking-market.pdf

[7] http://www.scoronline.co.uk/sites/default/files/high_level_prinicples_document_final.pdf

The Information Commissioner's Office monitors how CRA data is compiled in line with the Data Protection Act.

[8] See FCA Occasional Paper No.28 for an evaluation of CRA (and other) data.

3 Overview of UK personal debt

Market size overview

3.1 The Bank of England estimates outstanding UK consumer credit debt to be £198bn which equates to 13% of total (mortgage and consumer credit) outstanding household debt.[9] Previous analysis of the Office for National Statistics (ONS) survey data found that these debts are unevenly distributed across the population.[10]

3.2 When we compare our consumer credit debt estimates to figures compiled by the Bank of England and Office for National Statistics (ONS) we find them to almost reconcile – for a variety of reasons these figures diverge the further back in time we look at our data as explained in Appendix 1. The CRA data we use for this analysis are not expected to perfectly align with these other sources as our data is a sample of data, not all lenders report to these data and the definitions used differ.

3.3 In our data, described in Table 1, we estimate there to be £160bn of outstanding personal debt in November 2016. Personal debt estimates include both consumer credit agreements (e.g. credit cards, personal loans, home-collected credit) and other household debts (e.g. telephone and utility bills). This figure is lower than the Bank of England/ONS consumer credit estimates. This is mainly because our estimates exclude the credit card balances where consumers repay their debt in full that month (known as 'transactors') and CRA data does not contain information on some lenders – this mainly affects motor finance.

Table 1: Estimated sizes of UK personal debt based on sample of CRA data

Categories	Stock of outstanding credit items (November 2016)	Annual flow of newly originated credit items (December 2015 – November 2016)
Number of credit items[11]	199 million	31 million
Value of credit items	£160 billion	£79 billion[12]

3.4 Figure 1 examines which products contribute most to this £160bn stock of outstanding personal debt. It shows how mainstream credit products – credit cards, motor finance, unsecured personal loans and overdrafts – account for the overwhelming majority of consumers' outstanding personal debt.

3.5 Although less mainstream credit products – such as rent-to-own and home-collected credit agreements – account for a minority of personal debt they are often have high

[9] Consumer credit covers non-mortgage debts held by individuals such as credit cards, unsecured personal loan and motor finance agreements. Bank of England series LPMBI2P (consumer credit) and LPMVTXH (mortgages), April 2017. This is using a combination of data submitted by lenders to the Bank of England and from the ONS monthly survey of consumer credit grantors. Note that the consumer credit figure is before repayments and therefore includes credit card debts of 'transactors' where consumers who repay their credit card debt in full at the end of a month.

[10] ONS Wealth & Assets Survey wave 4, Gathergood & Guttman-Kenney (2016) Can we predict which consumer credit users will suffer financial distress? *FCA Occasional Paper 20*, August 2016. https://www.fca.org.uk/publication/occasional-papers/occasional-paper-20.pdf

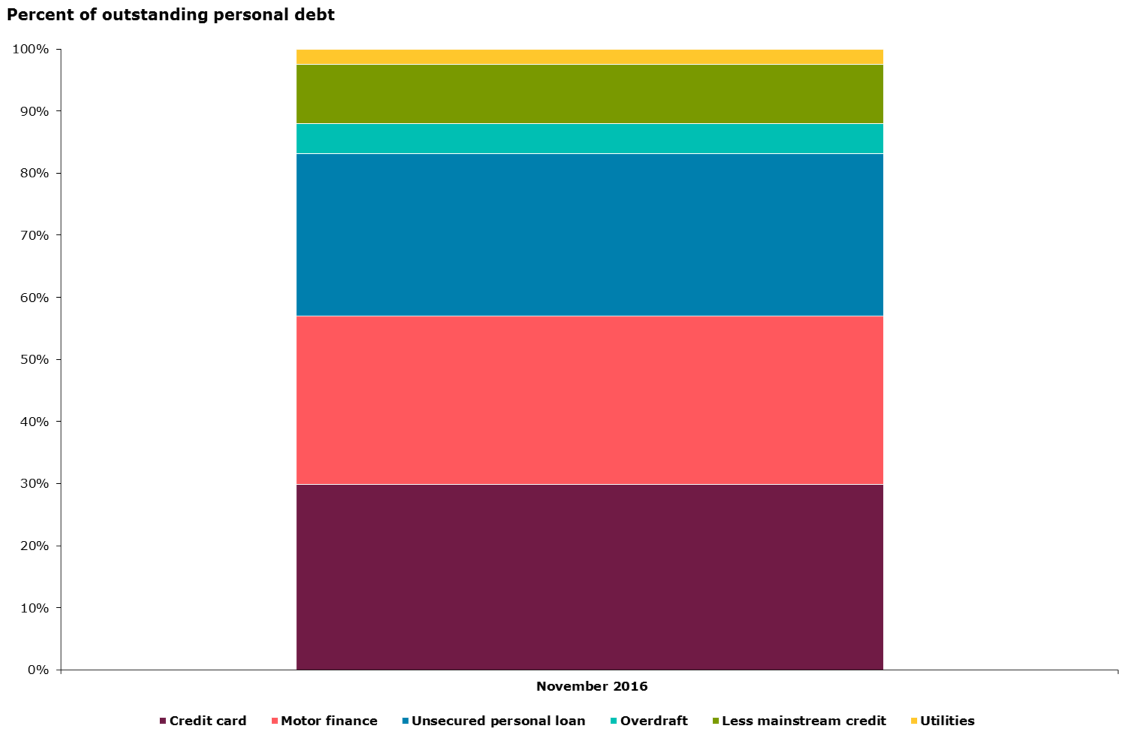
[11] Note that not all of these credit items have outstanding personal debt at a point-in-time

[12] For instalment-based products we use the origination amount, for revolving products as credit cards the credit limit is used.

costs of borrowing and, as we go on to show later in this document, are used by especially vulnerable groups of consumers.

3.6 Utility bill debt accounts for a small fraction of overall debt, however, such debt is a sign of severe financial distress as these accounts typically only report positive balances when the consumer is in arrears or default. It therefore highlights these consumers are unable to meet essential payments such as heating bills.

Figure 1: Share of outstanding value of personal debt across mainstream credit (credit card, motor finance, unsecured personal loan and overdraft), less mainstream credit and utilities (November 2016)



3.7 Table 2 displays the average (mean) value per credit item originated over 12 months to November 2016 – for credit products with credit lines (e.g. credit cards, overdrafts, catalogue credit) we use the size of the credit limit. It also shows two measures of average (mean) value of outstanding debt - calculated based on outstanding credit items (i.e. including credit items with zero balances) and those credit items with debt (i.e. excluding credit items with zero balances).

3.8 Examining how the size of credit items varies by product type shows the diversity of these markets. For example, there are a variety of markets where average size per credit item originated and outstanding balance (across products) are a few hundred pounds such as high-cost short-term credit (HCSTC) whereas other markets such as motor finance agreements are more commonly in the tens of thousands of pounds.[13]

3.9 For some markets, most notably credit cards, the average value of outstanding debt masks the broad spectrum of balances. The majority of credit card accounts have no debt, some consumers have small debts of a few hundreds of pounds and others owe thousands or even tens of thousands of pounds. To illustrate this, the mean value of credit card debt per credit card is under £1,000 whereas focusing on only the cards with debt it is over £2,000.

[13] For revolving products this is calculated using the credit limits

Table 2: Average value of originations (December 2015 – November 2016) and outstanding debt (November 2016) per credit item[14]

Product category	Product name	Average (mean) value of credit originated (or starting credit limit for revolving products)[15]	Average (mean) value of outstanding debt per credit item	Average (mean) value of outstanding debt per credit item with positive debt
Mainstream credit	Credit card	£3,220	£960	£2,300
	Overdraft	£120	£130	£890
	Motor finance	£15,070	£11,020	£11,320
	Unsecured personal loan	£8,720	£6,080	£6,230
Less mainstream credit	Catalogue credit	£320	£360	£570
	Charge card	N/A[16]	£1,610	£2,100
	Guarantor loan	£3,900	£3,430	£3,470
	High-cost short-term credit (HCSTC)	£290	£390	£400
	Home credit	£760	£550	£560
	Logbook loan	£2,980	£2,320	£2,430
	Other running account[17]	£680	£270	£410
	Retail finance	£1,790	£1,170	£1,250
	Rent-to-own	£1,120	£650	£710
	Store card	£560	£220	£460
Utilities	Telecommunications	£110	£80	£300
	Other household bills	£20	£70	£310

[14] Rounded to nearest £10

[15] Origination amount is taken as the credit limit at origination for revolving products – credit cards, overdrafts, store cards, catalogue credit and other running account.

[16] Charge cards do not have an origination amount or credit limit

[17] This is a catch-all term for revolving credit products which do not fit in other categories

Consumer circumstances

3.10 At the end of 2016, an estimated 27.4 million people had outstanding personal debt (Table 3). This represents just over half of the UK adult population.

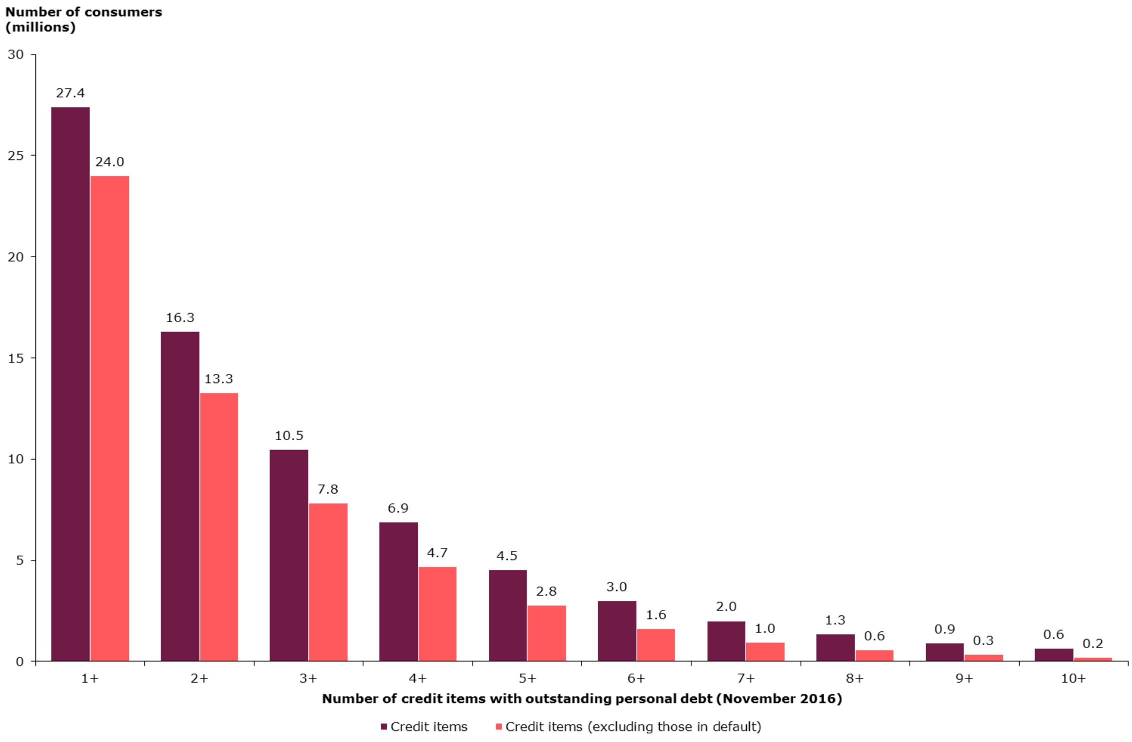
Table 3: Estimated number of consumers

Metric	Estimates
Adult population (mid-2016)[18]	51.8 million
Number of consumers with outstanding personal debt in November 2016 (% of adult population)	27.4 million (53.3%)

3.11 It is common for people in the UK to hold multiple credit items – the median consumer in our data has three credit items. Current accounts, credit cards and utilities are the most common credit items observed in these data. However, it is less common to have multiple credit items with outstanding debt – the median person has one credit item with outstanding debt.

3.12 Among the 27.4 million people who have outstanding personal debt just under half, 11.1 million people, have debt on only one product. 4.5 million people have debt on five or more products and 0.6 million people on ten or more products – as shown in Figure 2.[19] These figures decrease if we focus on people's non-defaulted personal debts which are 'outstanding' debt but are unlikely to be repaid. Looking at the difference between these reveals there to be 3.4 million people whose only outstanding personal debt is in default.

Figure 2: Number of credit items consumers have outstanding personal debt on (November 2016)

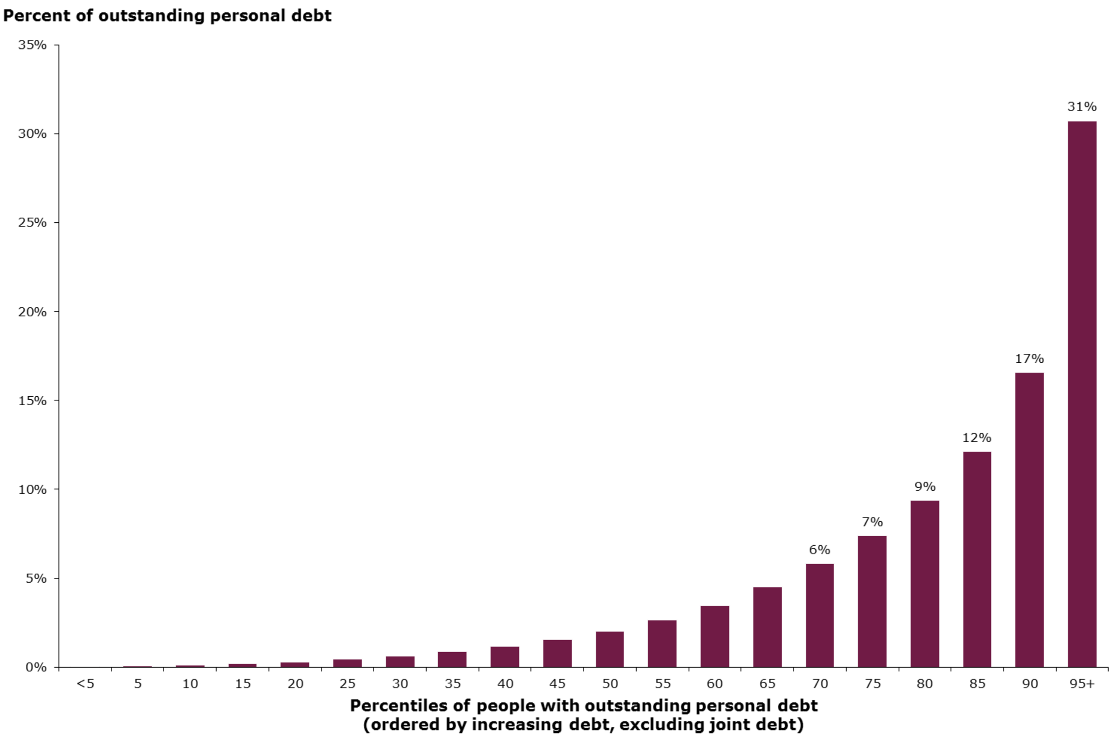


[18] ONS mid-2016 population estimates for people aged 18+ (MYE2) https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/datasets/populationestimatesforukenglandandwalesscotlandandnorthernireland

[19] Of people with 10 or more credit items, 19% have outstanding debt on 10 or more.

3.13 Among consumers with outstanding personal debt in November 2016 the mean and median amount owed was £6,000 and £2,200 respectively. Ordering consumers with outstanding personal debt in our data by the amount of this debt finds that debt is held very unevenly across consumers. As shown in Figure 3, a relatively small number of people hold a very large share of outstanding debt. Extrapolating these proportions to the UK adult population means that while 8 million people – 16% of UK adults - hold 82% of outstanding debts just 1.3 million people or 2.6% of UK adults hold over 30% of outstanding debt.[20] How to interpret this debt concentration depends upon who the consumers are – for example, if these people have very high incomes it is likely to indicate a greater ability to service this debt.

Figure 3: Shares of outstanding personal debt (November 2016)

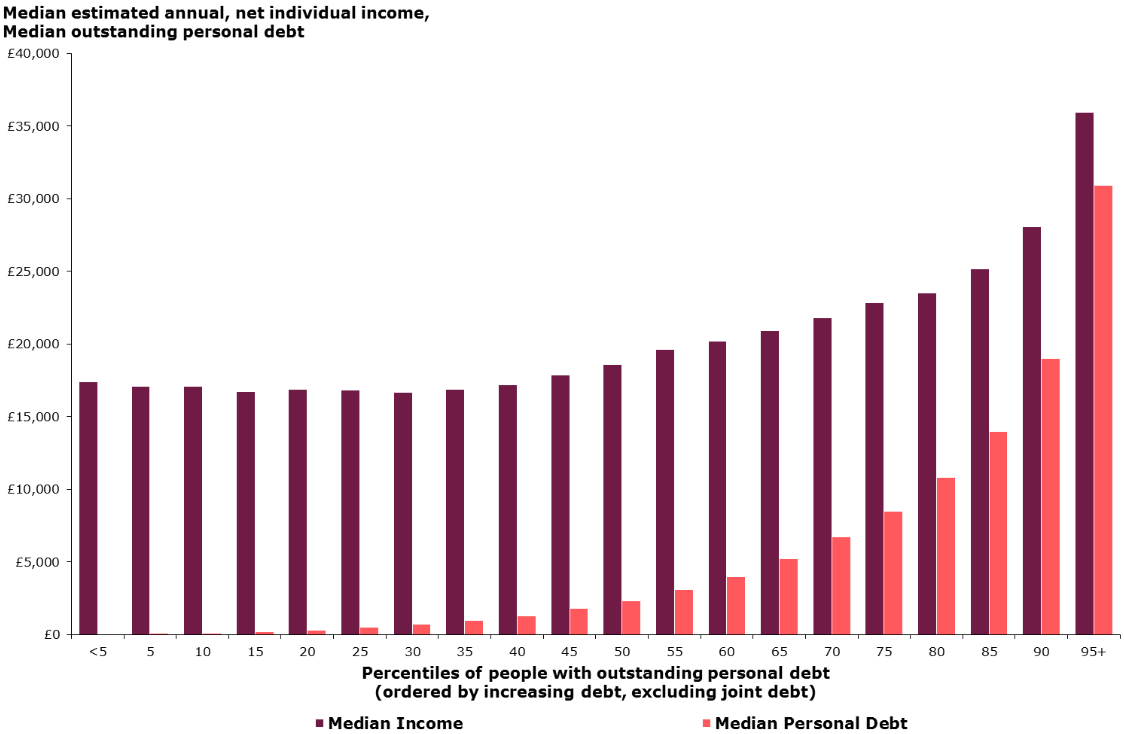


3.14 Figure 4 uses this same ordering of consumers - 20 equally sized groups (quintiles) ordered by outstanding personal debt. For each of these groups the figure presents the median values of debts and incomes. The top group of 1.3 million people (95+ percentile of outstanding debt) who account for over 30% of total debts have estimated mean and median annual, net individual income £35,900 and £30,900 respectively – which is the top 75% percentile of UK taxpayers.[21] In terms of the rest of the distribution we observe that median incomes are under £20,000 for most borrowers but are noticeably higher for the 15% of borrowers with largest personal debt outstanding.

[20] This excludes jointly-held personal debt so as not to over-state the amount of debt owed by an individual as opposed to a household. Including joint personal debt makes little difference – 2.7% of UK adults have 30% of debt.

[21] HMRC Survey of Personal Incomes for tax year 2015 to 2015

Figure 4: Median debts and incomes of consumers ordered by quantiles of outstanding personal debt (November 2016)



3.15 A particularly important segmentation of consumers is by credit scores - which measures an individual's likelihood to enter serious arrears or default on credit agreements (their 'credit risk'). Consumers with lower credit scores are typically unable to access cheaper forms of credit as they pose high risks for lenders. Prior research has shown that this is a highly correlated to and is strongly predictive of the likelihood of consumers suffering observable, objective measures of financial distress.[22] The credit score we use is scaled from 0 to 100 where a lower value indicates increased credit risk (lower likelihood of repaying debt).

3.16 Figure 5 displays the distribution of credit score for all consumers in our data (irrespective of whether they have outstanding debt), consumers with outstanding mortgage or personal debt and finally consumers with outstanding personal debt (irrespective of mortgage debt) as of November 2016. Where the line is higher this represents a higher proportion of people have credit scores at this value. The credit scores of those with outstanding personal debt are lower than the overall population and those with any mortgage or personal debt.

3.17 Part of the reason for lower credit scores of those people with personal debt is demographic as these consumers are at an earlier stage in their lives when it can be rational to temporarily borrow if they expect their incomes to rise over time.[23]

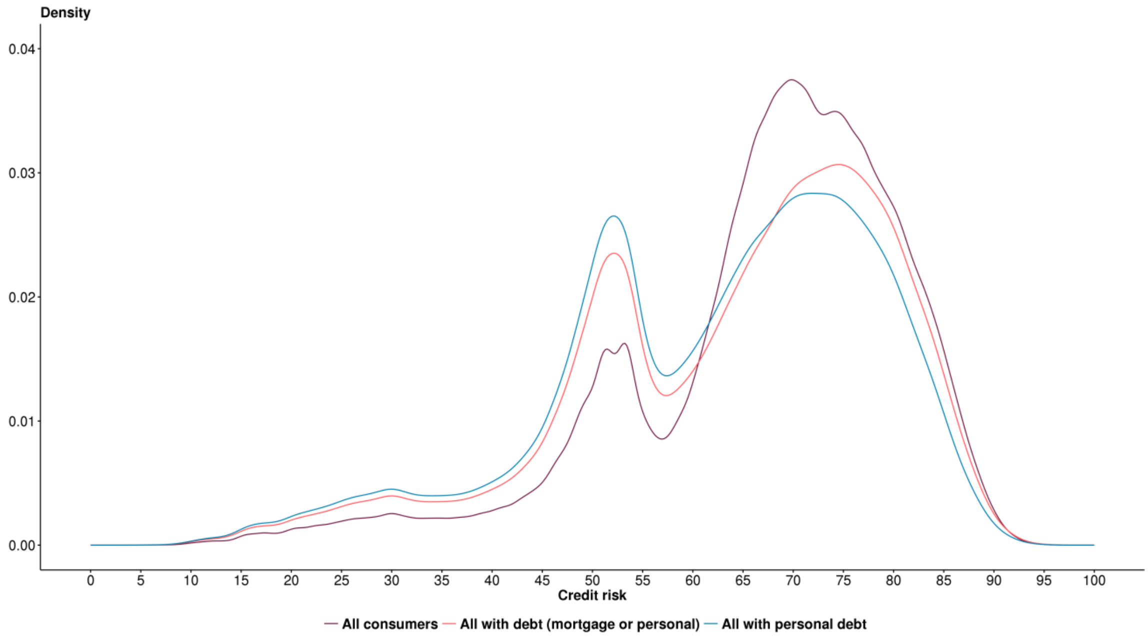
3.18 We interpret these data as showing that people can be broadly categorised into three groupings by credit score. 'Prime' consumers with high scores are in the upper half of the score distribution accounting for the majority of people (with or without debt) are. 'New-to-credit' consumers are the narrow bump in the middle of the credit score distribution with little or no credit histories – sometimes called 'thin' files. Finally, 'subprime' consumers occupy the long tail of the bottom of the credit score distribution.

[22] FCA Occasional Paper No.28

[23] See FCA Occasional Paper No.20 (Gathergood & Guttman-Kenney, 2016) chapter two for a fuller explanation of how borrowing changes over the course of people's lives.

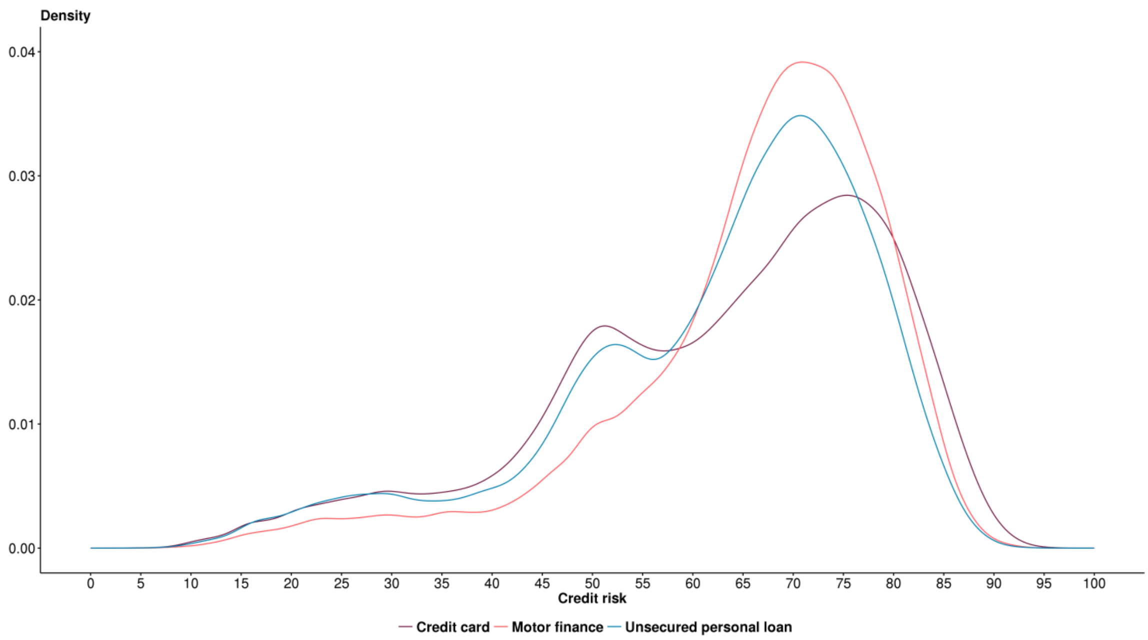
3.19 Personal debt is often taken out by consumers who are new-to-credit. This is shown in Figure 5 where, compared to all consumers, a higher proportion of consumers with outstanding personal debt are near the middle of the credit score distribution.

Figure 5: Distribution of January 2017 credit score of consumers with outstanding personal debt in November 2016 compared to all consumers in credit file and those with outstanding mortgage or personal debt



3.20 Within the distribution of those with outstanding personal debt we examine how this varies by those holding different types of mainstream credit – credit cards, motor finance and unsecured personal loans. Figure 6 shows that consumers with outstanding motor finance debt typically have higher credit scores (lower credit risk) than those with credit card or unsecured personal loan debt outstanding.

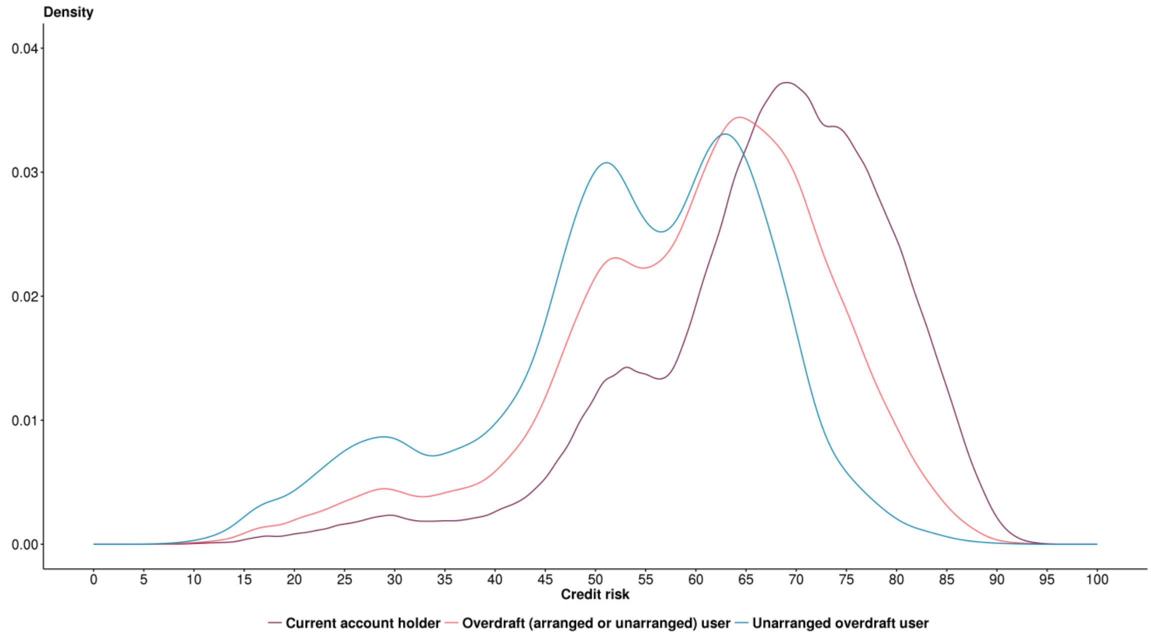
Figure 6: Distribution of January 2017 credit scores of consumers holding personal debt on credit card, motor finance or unsecured personal loan (November 2016)



3.21 We examine the credit score profile of overdraft (arranged or unarranged) users separately to compare them to people with current accounts and those using unarranged overdrafts. CRA data is a point-in-time monthly snapshot of overdraft use and therefore we do not observe the full details of consumer use of overdrafts within a month. We therefore expect it to under-represent consumer use of overdrafts.

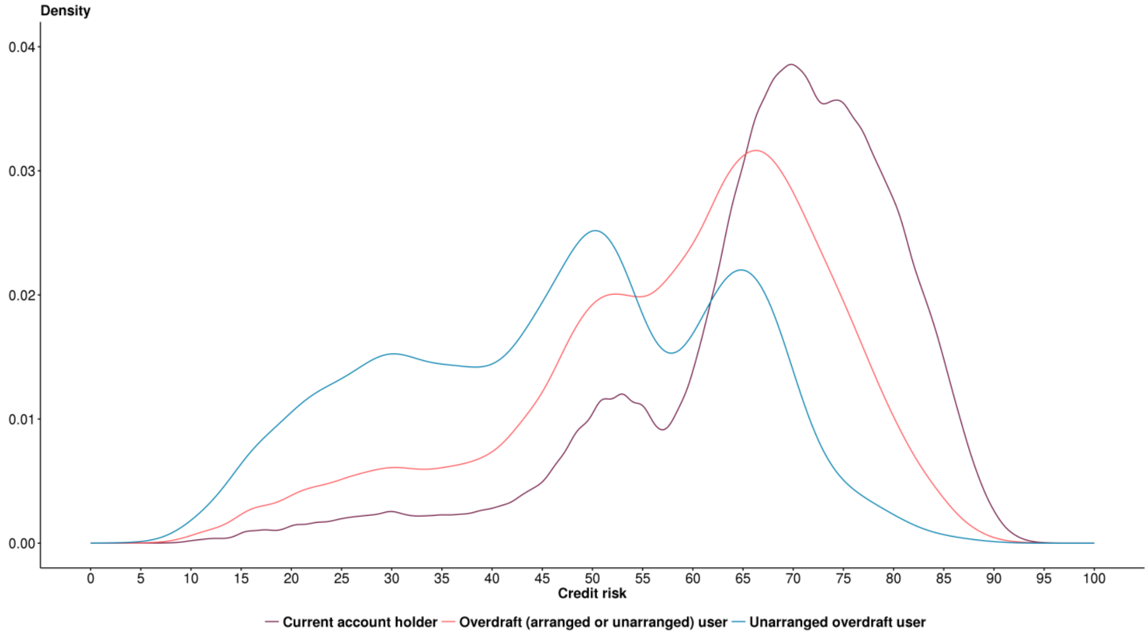
3.22 When we examine the credit score profile of overdraft users in Figure 7 we observe the customer base to typically have lower scores than consumers with current accounts or those with personal debts on other mainstream credit products. Consumers using unarranged overdrafts have noticeably lower credit scores than the overall population of current account and overdraft users.

Figure 7: Distribution of January 2015 credit score of consumers with current accounts in November 2016 compared to the subset of those with any overdraft or unarranged overdraft outstanding, non-defaulted debt



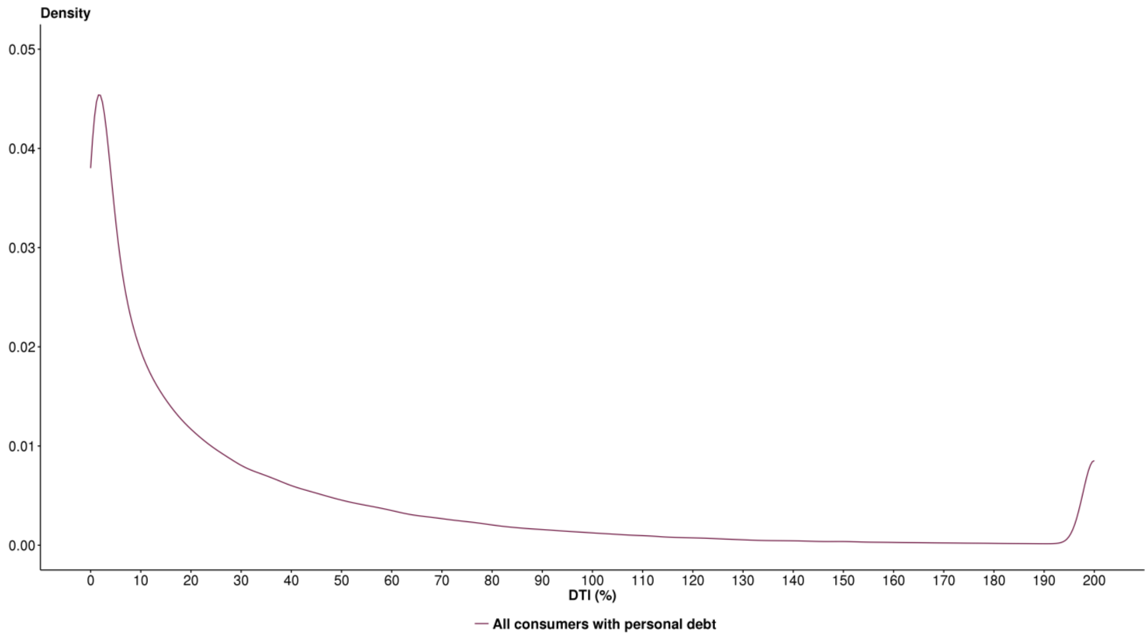
3.23 Overall the credit scores of people using overdrafts in November 2016 have worsened from January 2015, shown in Figure 7, to January 2017 which is displayed in Figure 8.

Figure 8: Distribution of January 2017 credit score of consumers with current accounts in November 2016 compared to the subset of those with any overdraft or unarranged overdraft outstanding, non-defaulted debt



3.24 Figure 9 displays the distribution of the ratio of total outstanding personal debt to estimated annual, net individual income (DTI) ratio among those with outstanding personal debt in November 2016. The mean and median DTI ratio are 35% and 15% respectively.

Figure 9: Distribution of January 2017 DTI ratio of consumers with outstanding personal debt in November 2016



3.25 In Figure 10 we split this by those with outstanding credit card, motor finance or unsecured personal loan debt. We keep the axes the same to facilitate comparison with the previous chart. This shows that consumers with credit cards have, on average, lower DTI ratios than those with motor finance or unsecured personal loan debt outstanding. Finally, Figure 11 shows that consumers using overdrafts have significantly higher DTI ratios than other current account holders. Those using unarranged overdrafts have higher DTI ratios than users of arranged overdrafts.

Figure 10: Distribution of January 2017 DTI ratio of consumers with outstanding personal debt in November 2016 compared to the subset of those with credit card, motor finance or unsecured personal loan debt

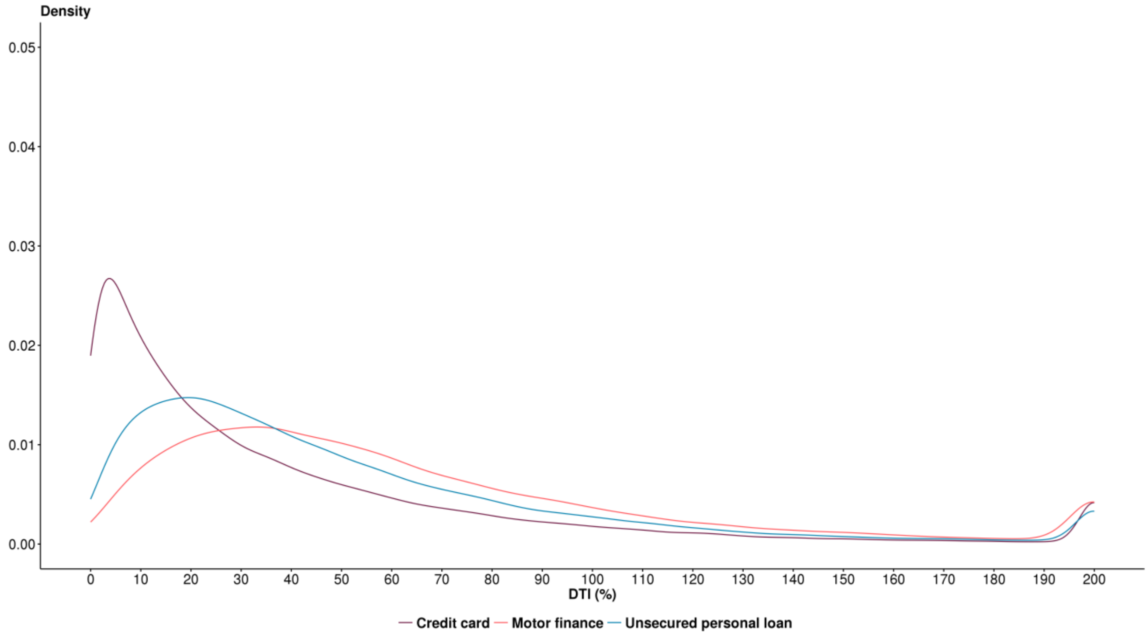
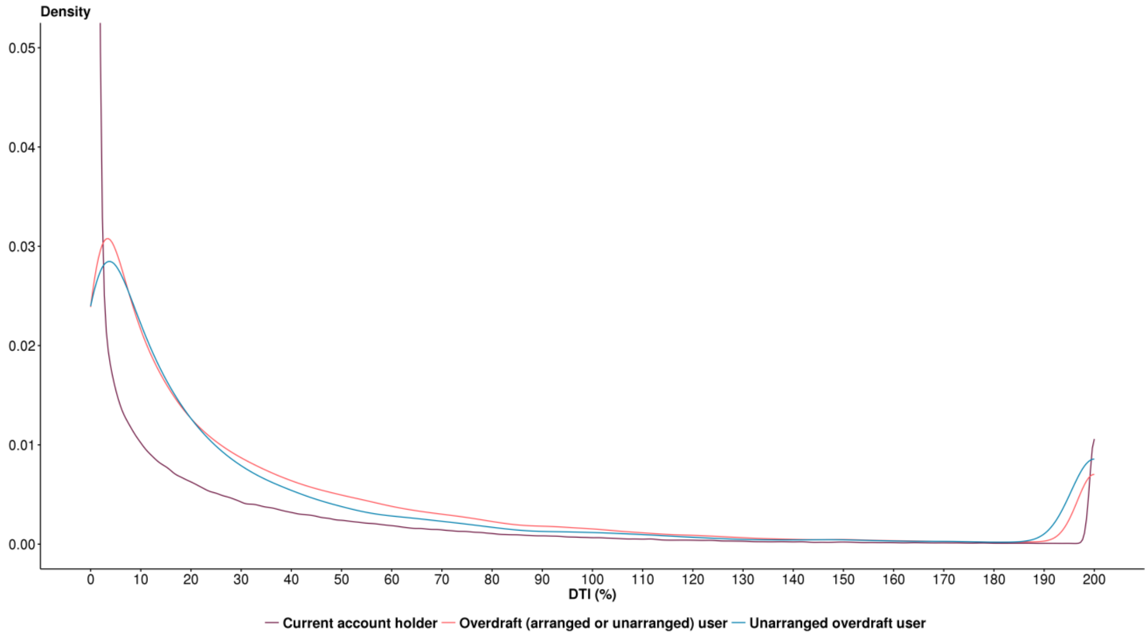


Figure 11: Distribution of January 2017 DTI ratio of consumers with current accounts in November 2016 compared to the subset of those with any overdraft or unarranged overdraft outstanding, non-defaulted debt



4 Comparison of less mainstream credit products

Market size

4.1 This chapter compares a variety of less mainstream credit products – some of these may potentially considered to be high-cost credit based on their pricing structure or profile of borrowers. Some mainstream products - credit cards, unsecured personal loans, overdrafts and motor finance – may also potentially be considered high-cost credit but are not the focus of this chapter.

4.2 Table 4 compares the estimated market sizes for these less mainstream credit products using a variety of measures. This shows market size in terms of the number of consumers taking out products in a year or holding debt on a product. It also shows the number and value of annual credit originations – in the case of revolving credit products the credit limit is used. The final market size metric is the value of the outstanding stock of debt.

4.3 Catalogue credit and retail finance products have significantly larger customer bases than other less mainstream markets including HCSTC, home credit and rent-to-own. Catalogue credit agreements typically have higher costs of borrowing than retail finance agreements.

4.4 The short-term nature of HCSTC loans means that, by number of originations, this is largest market but by value of originations this is much smaller than other markets – especially retail finance – where credit agreements are typically much larger. By the value of outstanding debts, store credit is the largest, followed by retail finance and catalogue credit.

4.5 Catalogue credit and store credit are both established markets and the revolving nature of these products means the outstanding debt will be higher as, unlike loans, they do not necessarily amortise if the consumer keeps spending on these.

4.6 The guarantor loan market is noticeably smaller than many of the other less mainstream markets. However, this market has grown rapidly over the last few years.

4.7 The category ‘other running account’ is a catch-all term for other revolving credit products which do not neatly fit into the other categories. This market also appears to be growing but remains small.

4.8 The logbook loan market appears small by all measures; however, we do not expect to necessarily observe the majority of logbook loans in CRA data as the secured nature of the product mean the lender has less need to use (and therefore report to) such data to assess credit risk than lenders offering other products.

Table 4: Comparison of market sizes of less mainstream credit products (2016)

	Number of consumers with outstanding debt (million) [percent of UK adults]	**Annual number of consumers taking out product (million)**	**Annual number of originations (million)**	**Annual value of originations (billion)**	**Value of outstanding debt (billion)**
Catalogue credit	7.6 [14.7%]	1.9	2.5	£0.8	£4.0
Retail finance	5.3 [10.2%]	2.3	2.6	£4.4	£6.0
Store card	1.9 [3.7%]	0.4	0.4	£0.2	£0.7
HCSTC	1.6 [3.1%]	0.8	3.6	£1.1	£1.1
Home credit	1.6 [3.1%]	0.7	1.7	£1.3	£1.1
Rent-to-own	0.4 [0.8%]	0.2	0.6	£0.6	£0.5
Other running account	0.3 [0.6%]	0.2	0.2	£0.2	£1.0
Guarantor	0.1 [0.2%]	0.1	0.1	£0.2	£0.3
Logbook	<0.1 [<0.1%]	<0.1	<0.1	<£0.1	<£0.1

Credit performance

4.9 The most direct form of harm to consumers is becoming delinquent on loans – missing payments or not repaying their debts. Falling into delinquency often incurs additional charges for consumers and, if the lender reports to a CRA, this negatively affects the credit score of such consumers and impedes their ability to access credit in the future (at all or restricting access to higher-cost products).

4.10 Figure 12 and Figure 13 compare arrears and default rates by cohort of loan originations.[24] Given large seasonality in many of these markets we smooth these out using an average of 12 months of data to facilitate easier comparison across products and over time. This shows noticeable differences in both arrears and default rates between different product types.

4.11 We observe that while retail finance and catalogue credit markets are of a broadly similar size they have very different consumer outcomes. Catalogue credit has one of the highest arrears rates of the products examined whereas retail finance has the lowest. The default rates on catalogue credit are noticeably higher than other product types.

4.12 Analysing the home credit market, we observe that there have been substantial declines in the arrears and default rates on home credit loans over time yet arrears rates remain as one of the highest compared to other products.

4.13 Rent-to-own, logbook and guarantor loans all have lower default rates than other products. This is partially expected given the nature of these products having security for the lender against default (recovering an asset or collected debts from a guarantor) which are designed to deter consumers from defaulting. We treat figures for logbook loans with particular caution given the small sample sizes observed and our expectation that many agreements are not reported to CRAs.

4.14 The small, but growing market of 'other running account' has a variety of overdraft-type revolving credit facilities separate to a current account. Examining the performance of such agreements displays noticeably high arrears and default rates, however, we also treat these results with caution given the small size of this market and the mixture of products in this group.

[24] The 'arrears rate' as measured by whether any arrears or default are recorded on that loan on a borrower's credit file. The 'default rate' is defined as the proportion of loans originated which enter default as recorded on a borrower's credit file. These are assessed based on information in a credit file up to February 2017.

Figure 12: Comparison of arrears rates on less mainstream credit products by origination date (January 2013 – July 2016)

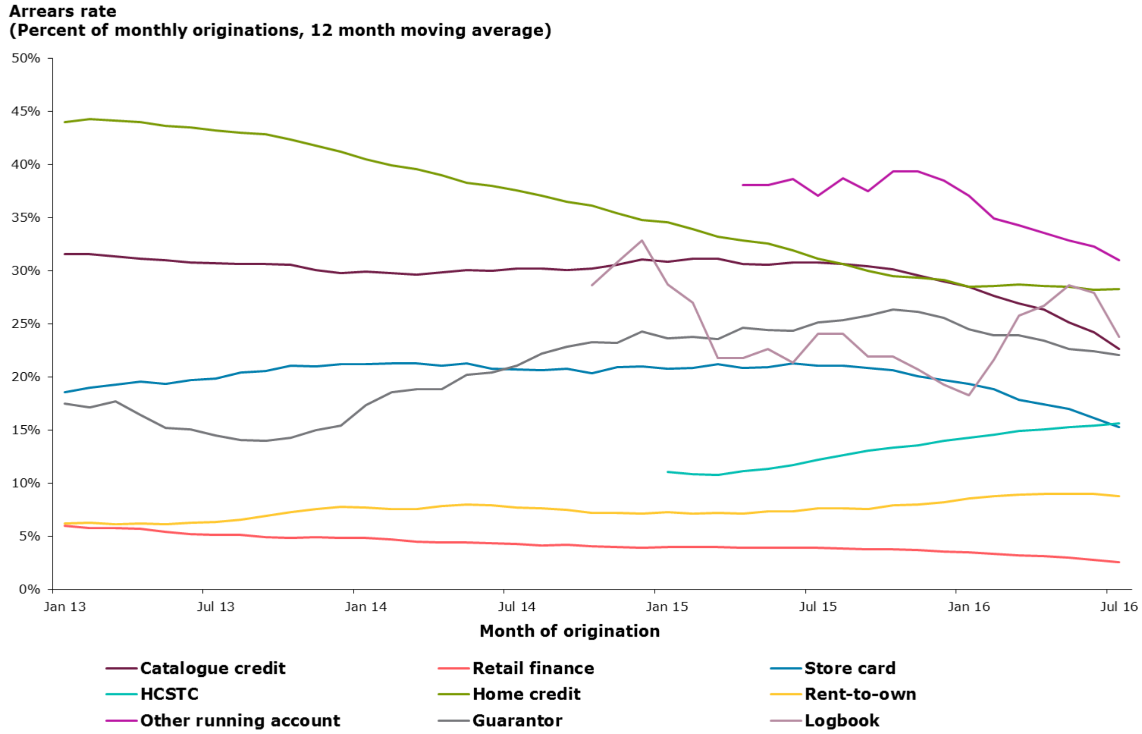
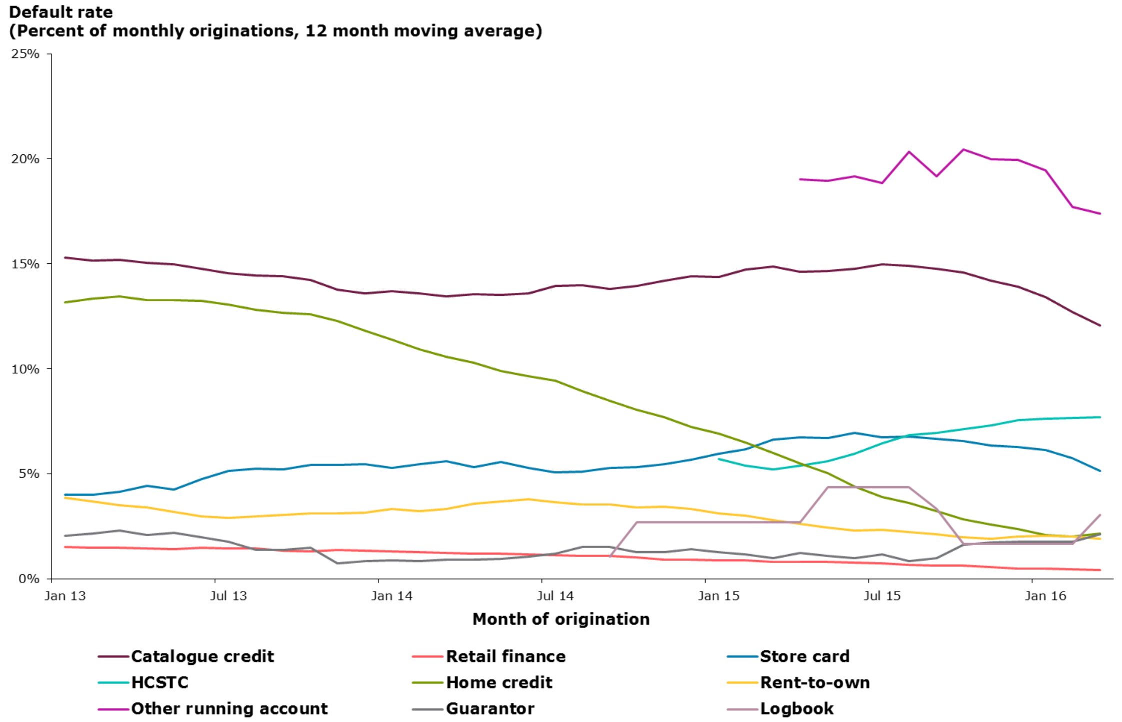
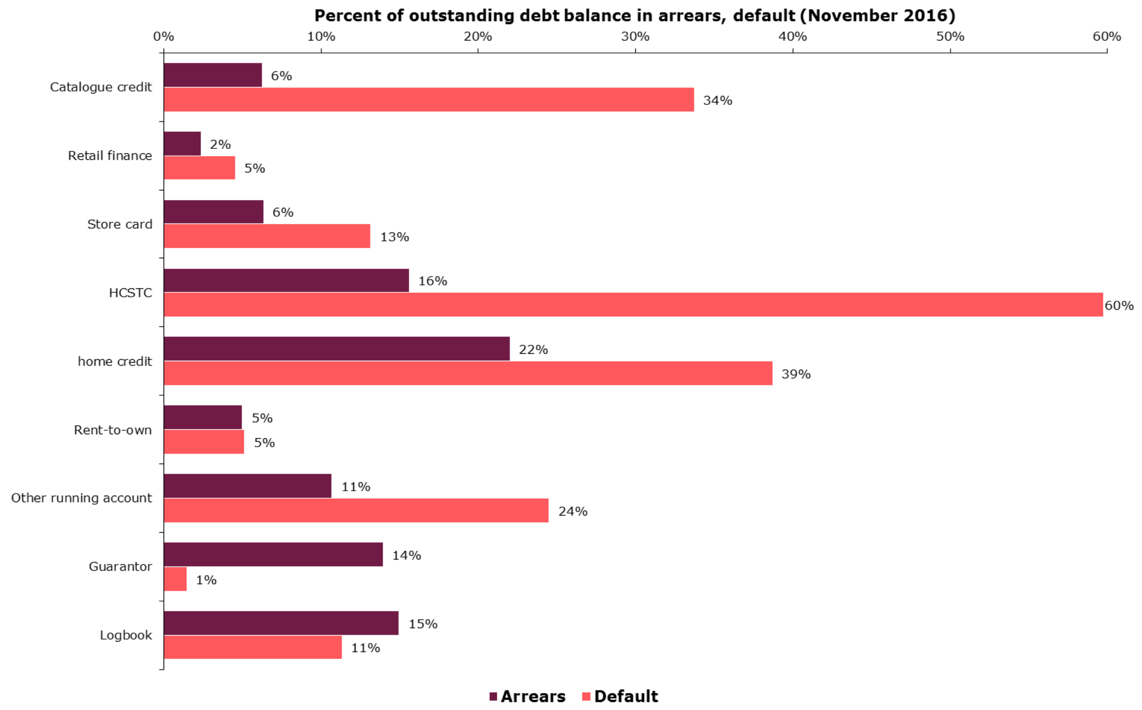


Figure 13: Comparison of default rates on less mainstream credit products by origination date (January 2013 – March 2016)



4.15 Figure 14 compares the outstanding balances in arrears and default shows how these vary substantially across less mainstream credit products. Retail finance, logbook, rent-to-own and logbook show comparatively low proportions of debts in default. Catalogue credit and home credit have some of the highest arrears rates. However, home credit has a much higher proportion of debt in default than catalogue credit. HCSTC has a high proportion in default – this is largely due to the short-term nature of the product as loans repaid on-time last one or only a few months whereas defaulted debts stay outstanding for a relatively substantially longer period of time.

Figure 14: Outstanding balances in arrears or default (November 2016)



Consumer circumstances

4.16 Table 5 provides an overview comparing the socio-economic profiles of the median person taking out less mainstream credit products in 2016. This shows how the users of these different products typically have quite different characteristics. We show the median age, credit score, amount of outstanding personal debt, estimated income, debt-to-income (DTI) ratio and number of products with outstanding personal debt.

Table 5: Comparison of consumer circumstances of median 2016 users of less mainstream credit products (January 2017 statistics)

	Median age	Median credit score (0-100)	Median outstanding personal debt	Median estimated annual, net income	Median DTI ratio[25]	Median number of products with outstanding personal debt
Catalogue credit	45	63	£1,300	£17,700	28%	2
Retail finance	41	69	£4,300	£24,700	19%	3
Store card	36	65	£1,100	£17,500	8%	2
HCSTC	32	42	£3,600	£20,000	18%	5
Home credit	42	41	£2,800	£15,500	22%	5
Rent-to-own	36	35	£4,300	£16,100	29%	8
Other running account	34	54	£4,300	£21,900	21%	4
Guarantor	33	40	£7,400	£20,800	32%	6
Logbook	38	32	£7,600	£23,300	26%	7

4.17 The credit score orders consumers based on their likelihood of repaying debt. A lower credit score indicates higher credit risk. The score used is scaled between 0 and 100. A score near zero indicates almost certainty the consumer will default (or enter severe arrears) on a credit agreement and a score near 100 that this is very unlikely to occur.

4.18 Figure 15 examines the profile of consumers who took out one of these products during 2016 using a standardised credit score (as of January 2015) assessing the likelihood of individuals repaying their debts ('credit risk').[26]

4.19 There are three humps in the distribution – one near the bottom for 'subprime' individuals with severe arrears or defaults, one spike in the middle for 'new-to-credit'

[25] The DTI ratio is the ratio of total outstanding personal debt to estimated annual, net individual income (DTI) ratio. It does not include mortgage debt.

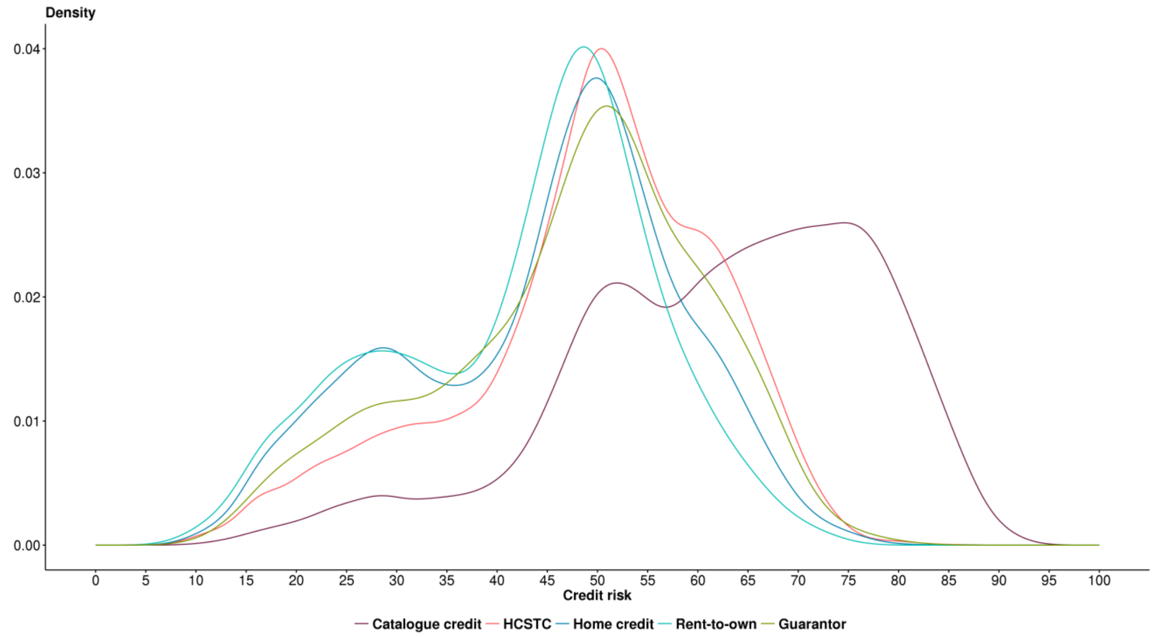
[26] We observe these scores at two points-in-time: January 2015 and January 2017.

people with little or no credit history and another hump near the top for 'prime' customers with high scores.

4.20 Three particular features stand out. Firstly, comparing results to the previous chapter shows that users of these less mainstream products have much worse credit score profiles (higher risk) than those with mainstream personal debt.

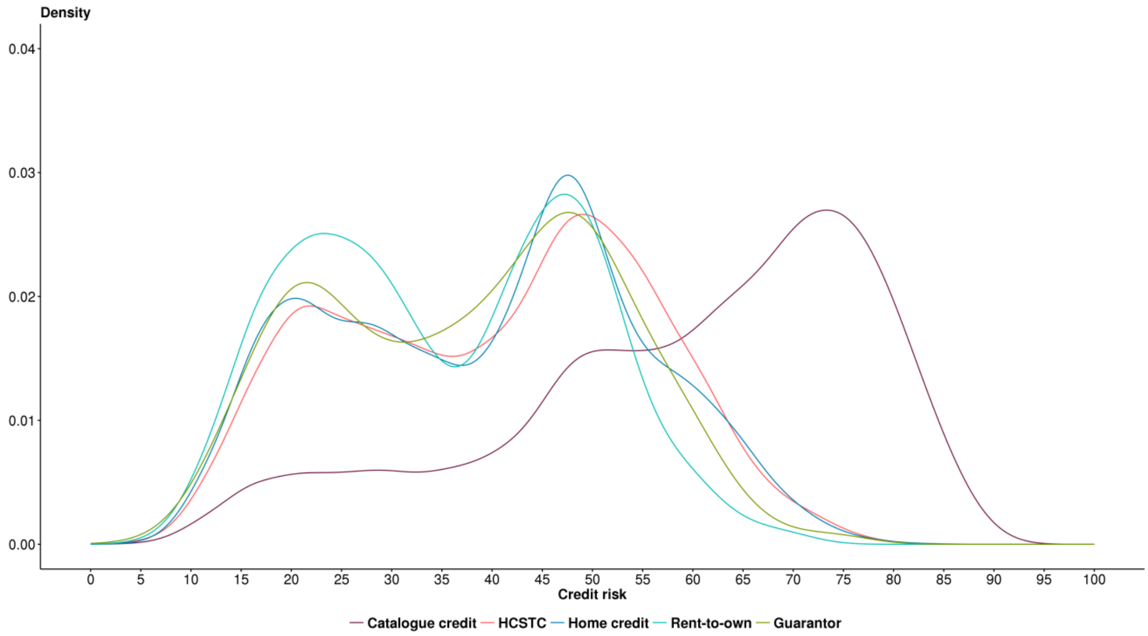
4.21 Secondly, the credit score distribution of users of most of these products are remarkably similar – rent-to-own and home credit customers have the lowest scores. This is despite these products having very different structures. Finally, retail finance and catalogue credit are the exceptions to this as they have higher scores with quite different distributions to other products. This last point is particularly interesting given how high arrears and default rates are on catalogue credit agreements despite having a customer base with much higher credit scores than other products.

Figure 15: January 2015 credit score profile of consumers taking out less mainstream consumer credit products during 2016



4.22 We then examine how the credit score profiles of these same consumers have changed by January 2017 in Figure 16. Comparing this to the preceding chart it is noticeable how the credit scores of these people, already low, have typically got even worse from 2015 to 2017. This is <u>*not*</u> to say it is only because of taking out such products their credit scores have got worse. The hump towards the bottom of the distribution has grown showing that many of these consumers are entering severe difficulties repaying debts.

Figure 16: January 2017 credit score profile of consumers taking out less mainstream consumer credit products during 2016



4.23 Comparing consumers taking out different less mainstream products – catalogue credit, rent-to-own, home-collected credit, HCSTC, store cards and guarantor loans - we observe a consistent pattern of significantly increasing indebtedness over a relatively short period of time (two years). Comparing the DTI ratios of these 2016 borrowers displays a similar deterioration between January 2015 (Figure 17) and January 2017 (Figure 18). Across users of these different products DTI ratios become higher on average with the distribution shifting to the right – showing increasing indebtedness.

Figure 17: Distribution of January 2015 DTI ratio of consumers taking out types of less mainstream products in November 2016

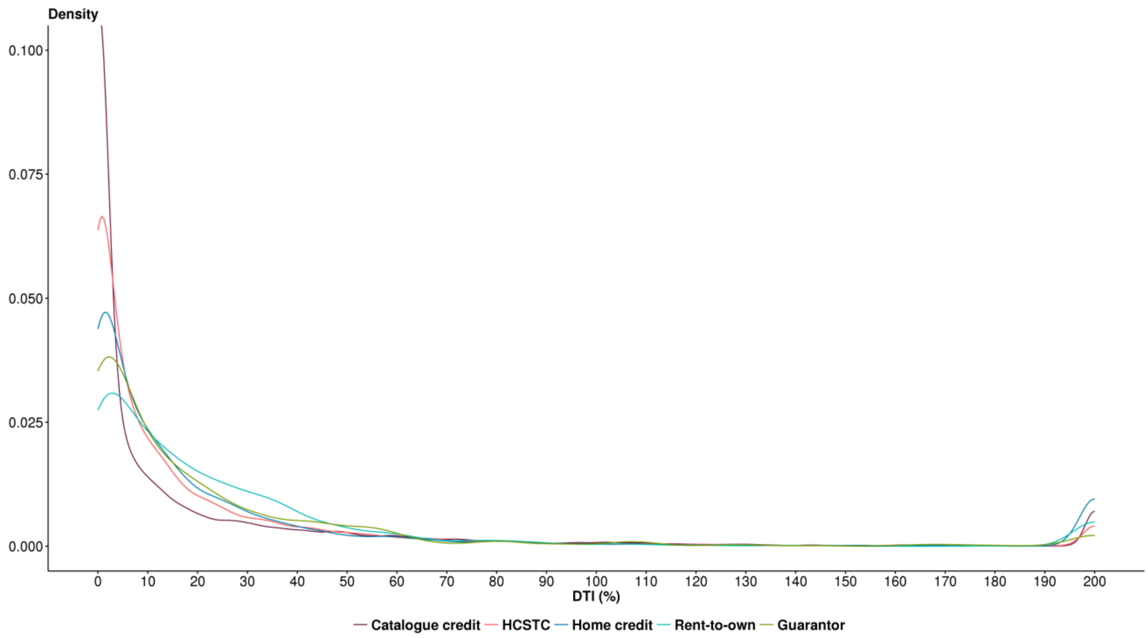
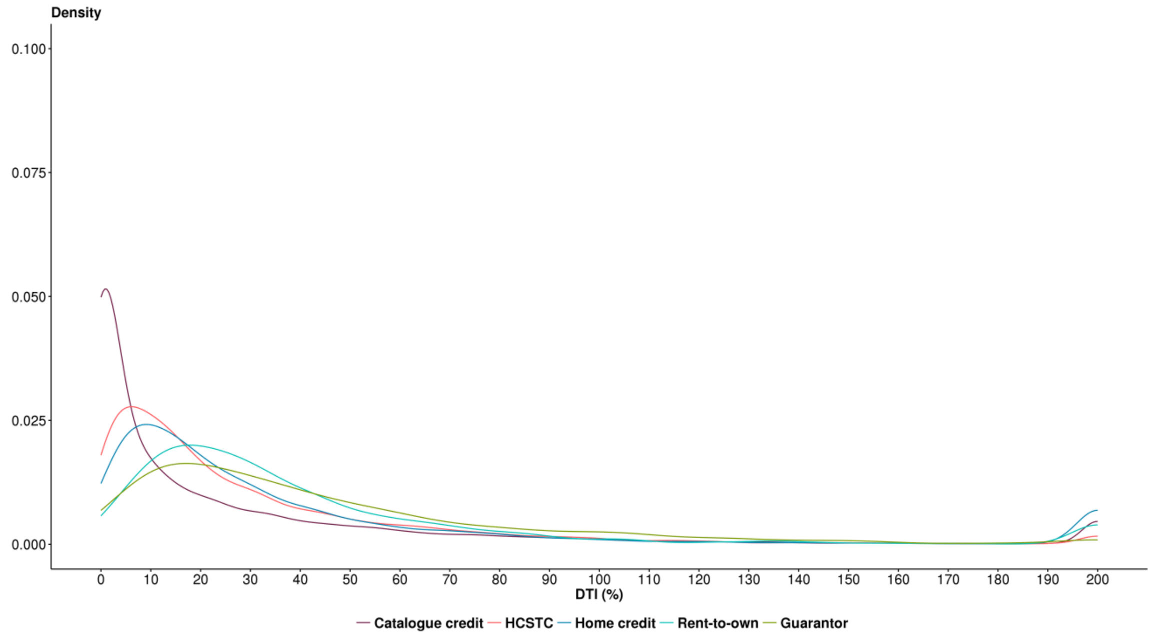


Figure 18: Distribution of January 2017 DTI ratio of consumers taking out types of less mainstream products in November 2016



4.24 We explore the other debts held by people taking out less mainstream credit products in Table 6. Here we take people who took out a less mainstream product in the last 12 months leading up to November 2016 (the columns) and examine the proportion of these people who had outstanding debt on mainstream, less mainstream and utility credit items as of November 2016 (the rows). We shade these with the products most commonly used in red and those least commonly used in green. Taking the column marked 'Catalogue credit' as an example, we see that 57% of people taking out catalogue credit agreement had outstanding catalogue credit debt as of November 2016. Looking further down this column we see 40% of these people had outstanding credit card debt and 20% had telecommunications bill debt.

Table 6: Products consumers taking out less mainstream products in 2016 have outstanding debt on as of November 2016

In November 2016, percent of consumers with outstanding debts on…	**Consumers taking out product (Dec 2015 – Nov 2016)**								
	Catalogue credit	Retail finance	Store card	HCSTC	Home credit	Rent-to-own	Other running account	Guarantor	Logbook
Catalogue credit	57%	16%	22%	32%	40%	46%	28%	38%	31%
Retail finance	12%	88%	16%	8%	5%	4%	16%	10%	4%
Store card	7%	7%	47%	7%	5%	4%	7%	7%	2%
HCSTC	7%	1%	4%	73%	19%	30%	38%	43%	54%
Home credit	8%	1%	3%	15%	94%	52%	10%	18%	46%
Rent-to-own	2%	<1%	1%	4%	12%	86%	3%	5%	4%
Other running account	1%	1%	1%	9%	3%	3%	55%	11%	21%
Guarantor loan	1%	<1%	1%	4%	2%	2%	5%	85%	2%
Logbook loan	<1%	<1%	<1%	<1%	<1%	<1%	1%	<1%	90%
Mortgage	20%	46%	20%	9%	5%	2%	21%	10%	8%
Credit card	40%	45%	38%	57%	37%	37%	56%	65%	67%
Overdraft	22%	19%	23%	50%	33%	40%	40%	54%	60%
Charge card	<1%	<1%	<1%	<1%	<1%	<1%	<1%	<1%	<1%
Unsecured personal loan	18%	28%	22%	29%	17%	20%	33%	29%	29%
Motor finance	9%	19%	11%	12%	6%	8%	15%	15%	15%
Telecommunications	20%	13%	16%	41%	40%	61%	31%	45%	50%
Other household bills	8%	5%	4%	10%	16%	21%	9%	13%	8%

4.25 Analysing these data shows large differences in how users of different products transition out of holding debt on such products. For home credit, guarantor lending and logbook, the overwhelming majority of people taking out these agreements between December 2015 and November 2016 have such debt outstanding in November 2016. Whereas other products such as catalogue credit and store cards around half of borrowers do not.

4.26 Across users of these different products it is common for consumers to have credit card debt and overdraft debt, although this does vary between products. For example, fewer than 40% of home credit customers hold credit card debt compared to over 65% of those with guarantor loans. There is a comparatively low prevalence of motor finance or unsecured personal loan debts held by these individuals.

4.27 For these customers bases it is uncommon to have outstanding mortgage debt. The exception to this is the retail finance market where 46% of borrowers have such debt. Relatively few users of other products have retail finance debt – indicating this market has a quite different customer base.

4.28 There is very low prevalence of store cards, logbook and guarantor loan debt across users of different products.

4.29 It is noticeable how a high proportion of users of many of these products have outstanding utility bill debt (telecommunications or other household bills). While such debts are typically a small proportion of overall balances, this reflects payment problems as positive balances are only recorded when the bill is in arrears or default. Users of HCSTC, home credit, rent-to-own, guarantor and logbook have noticeably high prevalence of such debts.

4.30 In a similar format to Table 6, Table 7 displays the share of outstanding personal debt on different credit products among people taking out less mainstream products.

4.31 This shows that credit cards, unsecured personal loans and motor finance account for the majority of the outstanding personal debts of consumers taking out a variety of less mainstream products. This is especially so for consumers taking out catalogue credit, retail finance, store card, HCSTC or other running account agreements. Across less mainstream products less than 10% of outstanding personal debt is overdraft debt. Utility bill debt accounts for a small share of outstanding personal debt.

4.32 For users of some less mainstream credit products the largest value of outstanding personal debt is on that particular product. Over a third of rent-to-own borrowers' debt is in these agreements. Just under a third of guarantor loan borrowers' debt is in such agreements. Over a quarter of home credit borrowers' debt is in home credit loans. Over a fifth of logbook loan borrowers' debt is in these loans.

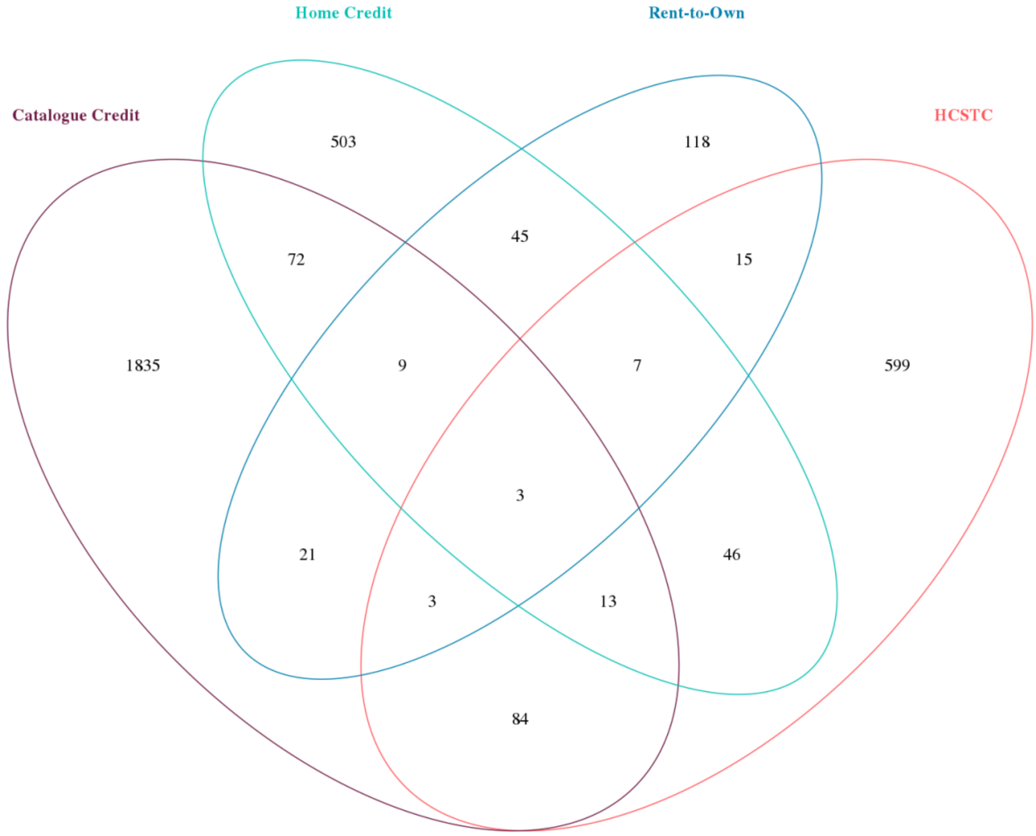
Table 7: Products consumers taking out less mainstream products in 2016 have outstanding debt on as of November 2016

In November 2016, percent of outstanding personal debt balances on…	Consumers taking out product (Dec 2015 – Nov 2016)								
	Catalogue credit	Retail finance	Store card	HCSTC	Home credit	Rent-to-own	Other running account	Guarantor	Logbook
Catalogue credit	9%	1%	3%	6%	10%	8%	4%	4%	4%
Retail finance	4%	17%	4%	2%	1%	1%	3%	2%	<1%
Store card	1%	<1%	3%	1%	1%	<1%	<1%	<1%	<1%
HCSTC	1%	<1%	1%	10%	3%	4%	5%	5%	8%
Home credit	2%	<1%	1%	2%	27%	11%	1%	2%	5%
Rent-to-own	1%	<1%	<1%	1%	5%	34%	1%	1%	<1%
Other running account	<1%	<1%	<1%	1%	<1%	<1%	3%	1%	1%
Guarantor loan	1%	<1%	<1%	3%	2%	1%	2%	32%	1%
Logbook loan	<1%	<1%	<1%	<1%	<1%	<1%	<1%	<1%	21%
Credit card	26%	21%	24%	22%	13%	6%	23%	15%	11%
Overdraft	5%	2%	4%	9%	5%	5%	5%	6%	7%
Charge card	<1%	<1%	<1%	<1%	<1%	<1%	<1%	<1%	<1%
Unsecured personal loan	25%	27%	31%	21%	11%	6%	26%	15%	12%
Motor finance	20%	27%	24%	17%	11%	10%	20%	12%	18%
Telecommunications	2%	<1%	1%	4%	6%	10%	3%	3%	10%
Other household bills	1%	<1%	<1%	1%	3%	3%	1%	1%	2%

4.33 To end this chapter we use Venn diagrams to examine whether consumers are taking out a variety of these less mainstream products. We focus on people who took out at least one catalogue credit, HCSTC, home credit or rent-to-own loan between December 2015 and November 2016 and seeing what combinations of credit products they also took out during this time. For example, do people taking out a rent-to-own loan also commonly take out a HCTSC loan and a home credit agreement?

4.34 Figure 19 shows that there are relatively few people who took out combinations of catalogue credit, home credit, rent-to-own and HCSTC loan within a 12 month period (December 2015 - November 2016). Approximately 3,000 people in the centre of the Venn diagram took out all of these products. However, we can see that some other combinations are more common – 13,000 people took out a catalogue credit, HCSTC loan and home credit loan.

Figure 19: Of consumers taking out at least one catalogue credit, home credit, rent-to-own or HCSTC loan between December 2015 and November 2016, the number taking out combinations of credit products during this time (numbers are thousands of consumers)

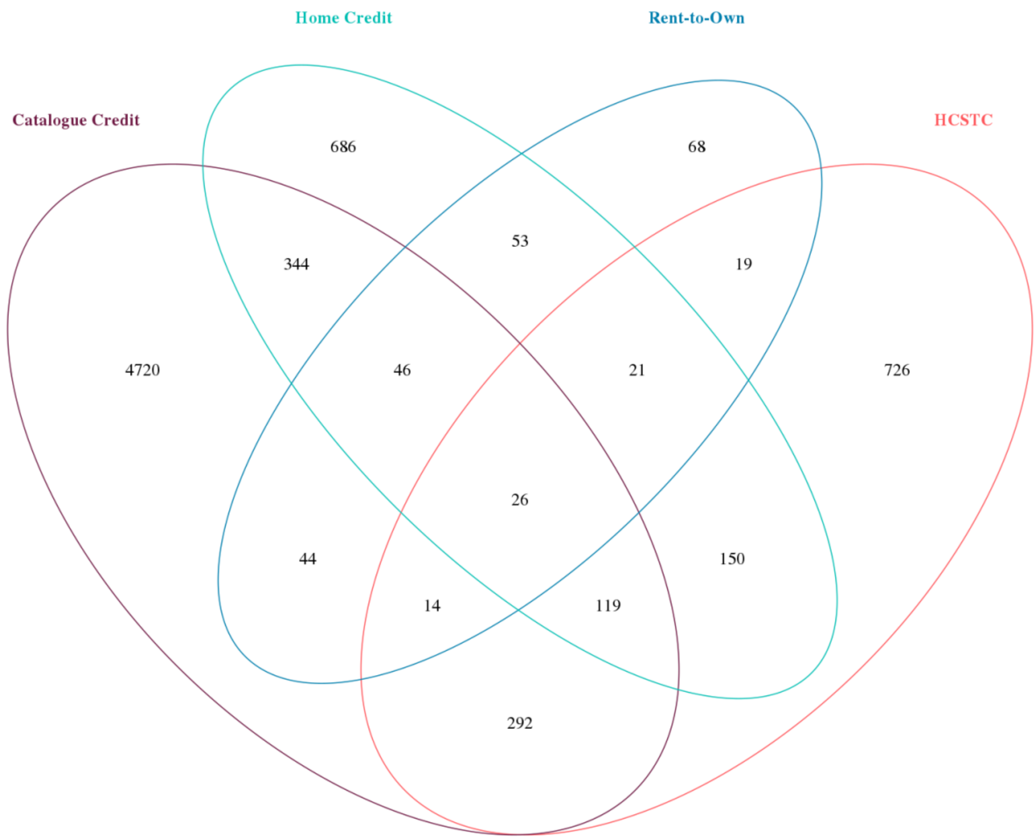


4.35 To complement this we examine the combination of personal debt people have outstanding. Is it that people with outstanding rent-to-own debt also commonly have outstanding debt on home credit and HCSTC loans?

4.36 Figure 20 examines those who had any outstanding personal debt on catalogue credit, home credit, rent-to-own or HCSTC loan debt as of November 2016 and which combinations of products they had outstanding debt on.

4.37 Here we see 26,000 people have outstanding debt on all of these products. Approximately 119,000 people have outstanding personal debt on catalogue credit, HCSTC and home credit. Please note the sample sizes become fairly small for these combinations so are potentially subject to greater uncertainty over the precise numbers but expect these to be reasonably accurate estimates. We include defaulted debt in these calculations and therefore the numbers of consumers in these groups declines when this this is excluded.

Figure 20: Of consumers with outstanding personal debt on at least one of catalogue credit, home credit, rent-to-own or HCSTC loan as of November 2016, the number with combinations of personal debt during this time (numbers are thousands of consumers)



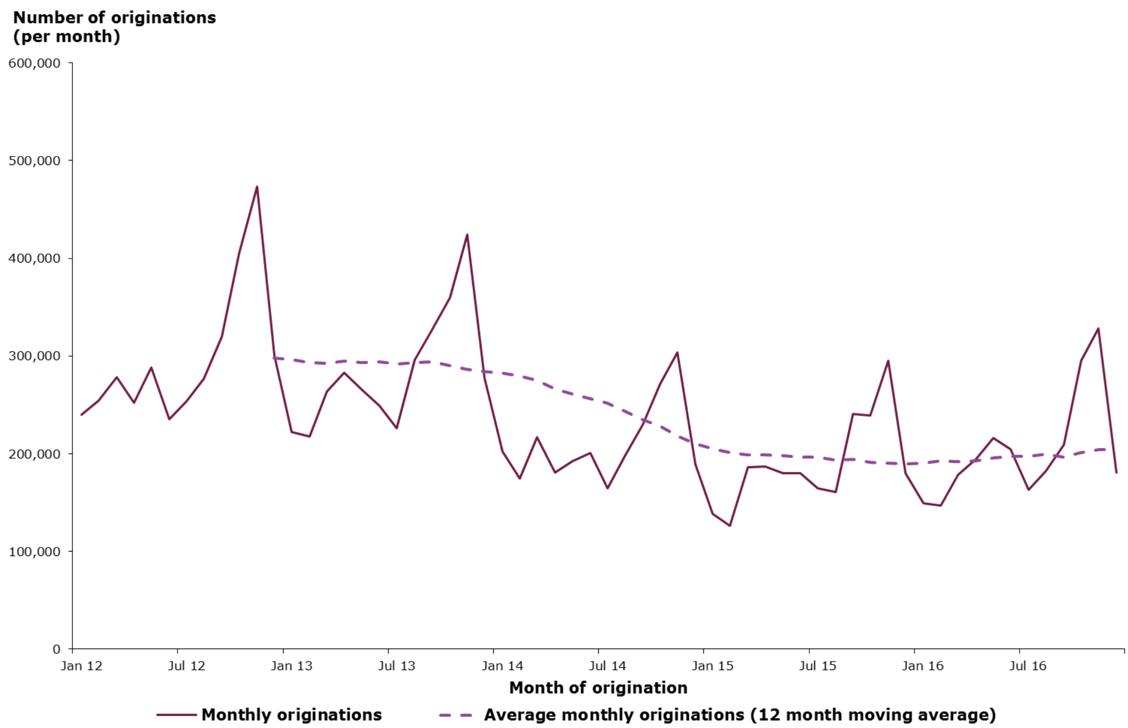
PART II: DETAILED ANALYSIS OF LESS MAINSTREAM CREDIT MARKETS

5 Catalogue credit

Market size

5.1 We now progress to part II of the document analysing particular products in greater depth. The first of these examined is catalogue credit. Catalogue credit agreements are typically credit agreements enabling an individual to borrow from one (or more) retailers up to an agreed credit limit. Catalogue credit (also known as mail order or home shopping catalogues) is one of the largest less mainstream markets. During 2016, there were over 200,000 new catalogue credit agreements taken out per month on average. There are large seasonal variations in this market which are shown in Figure 21. Over a quarter of annual lending occurs during October and November and there are smaller peaks around March and April in line with the timings of new clothing lines being put on sale.

Figure 21: Number of catalogue credit originations (January 2012 – December 2016)



5.2 In 2016, 1.9 million people took out catalogue credit which is significantly smaller than it was in 2013 where over 2.8 million people took out these products. While more people took out catalogue credit in 2016 than 2015, this followed several years of significant decline as shown in Table 8.

5.3 Almost 7.6 million people had catalogue credit debt on their credit file at the end of 2016. This is increasing over time from 7.2 million in 2014 to 7.3 million in 2015. Between 2012 and 2016 over 11.1 million people held debt on these products.

5.4 In 2016, the number and value of catalogue credit originations returned to its 2014 levels following a dip in 2015.[27] Throughout this time the average (mean) credit limit at origination remained close to £300. The £4.0bn value of total outstanding

[27] Value of origination is measured by credit limit

catalogue credit debt at the end of 2016 is a notable increase on previous years - £2.9bn and £3.4bn in 2014 and 2015 respectively. Since the number and value of new lending has changed relatively little this means the growth in debt is primarily driven by increasing consumer use of existing catalogue credit facilities.

Table 8: Size of catalogue credit market (2012 – 2016)

	Number of consumers taking out product (millions)	**Average (mean) value of credit limit at origination**	**Number of originations (millions)**	**Value of credit limit at origination (billions)**	**Value of outstanding debt (billions)**
2012	2.8	£280	3.6	£1.0	£1.8
2013	2.7	£280	3.4	£0.9	£2.5
2014	2.0	£310	2.5	£0.8	£2.9
2015	1.8	£320	2.3	£0.7	£3.4
2016	1.9	£320	2.5	£0.8	£4.0

Credit performance

5.5 Figure 22 takes annual cohorts of catalogue credit agreements issued between 2012 and 2015 (and the first half of 2016) and plots the cumulative proportion of these which enter arrears in months since origination.[28] From 2012 to 2015 there was little change in the proportion of catalogue credit agreements which eventually became delinquent (Figure 22) - around 30% of agreements went into arrears. We observe that significantly fewer new catalogue credit agreements opened in the first half of 2016 have become delinquent. However, these 2016 originations are following a similar path to the 2014 cohort as of up to 12 months since cohort origination.

5.6 As displayed in Figure 23, the proportion of new catalogue credit agreements entering default was consistently around 15% between 2012 and 2015. Defaults are typically not observed until six months after credit origination. The cohort of agreements issued during the first half of 2016 appear to be following a similar pattern to the 2014 cohort.

5.7

[28] This is known as vintage analysis. Each annual cohort (or vintage) is made up of 12 monthly cohorts (except 2016 H1 which contains six). The result of this is that the vintages mechanically flatten off for the last 11 months of data. For example, we observe loans issued in January 2014 for 37 months but 36 months for those issued in February 2015 and so on 26 months for December 2014.

Figure 22: Arrears rates by vintage of catalogue credit origination (January 2012 – June 2016)

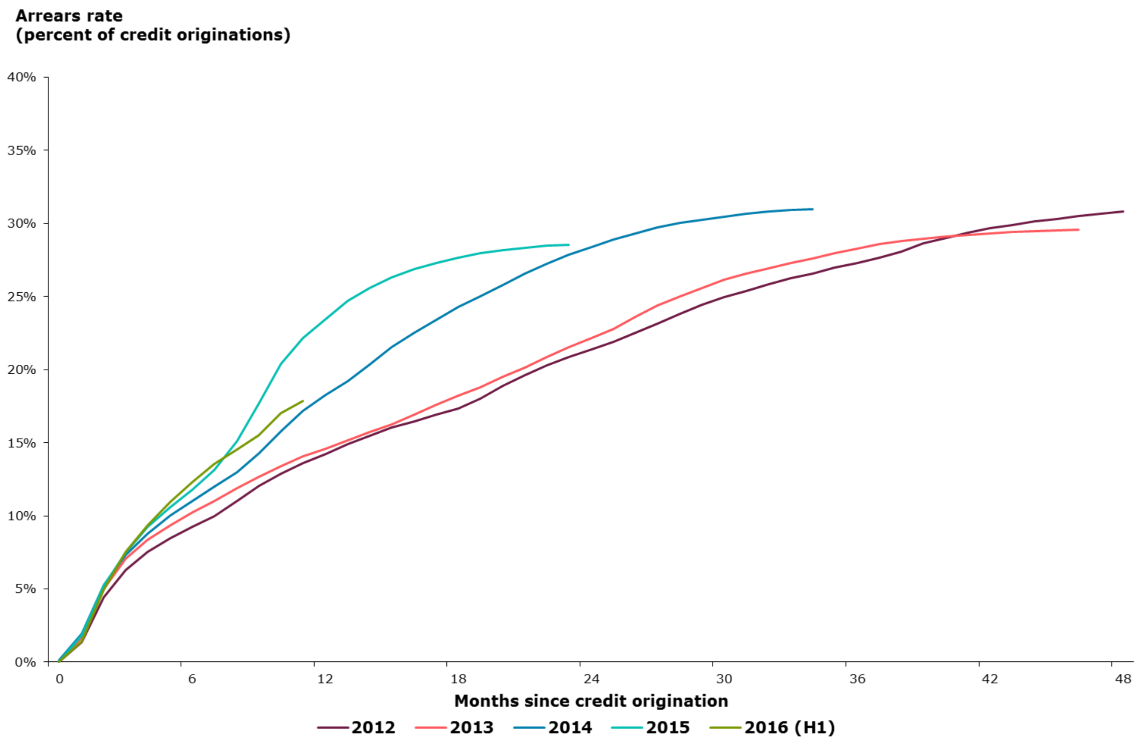
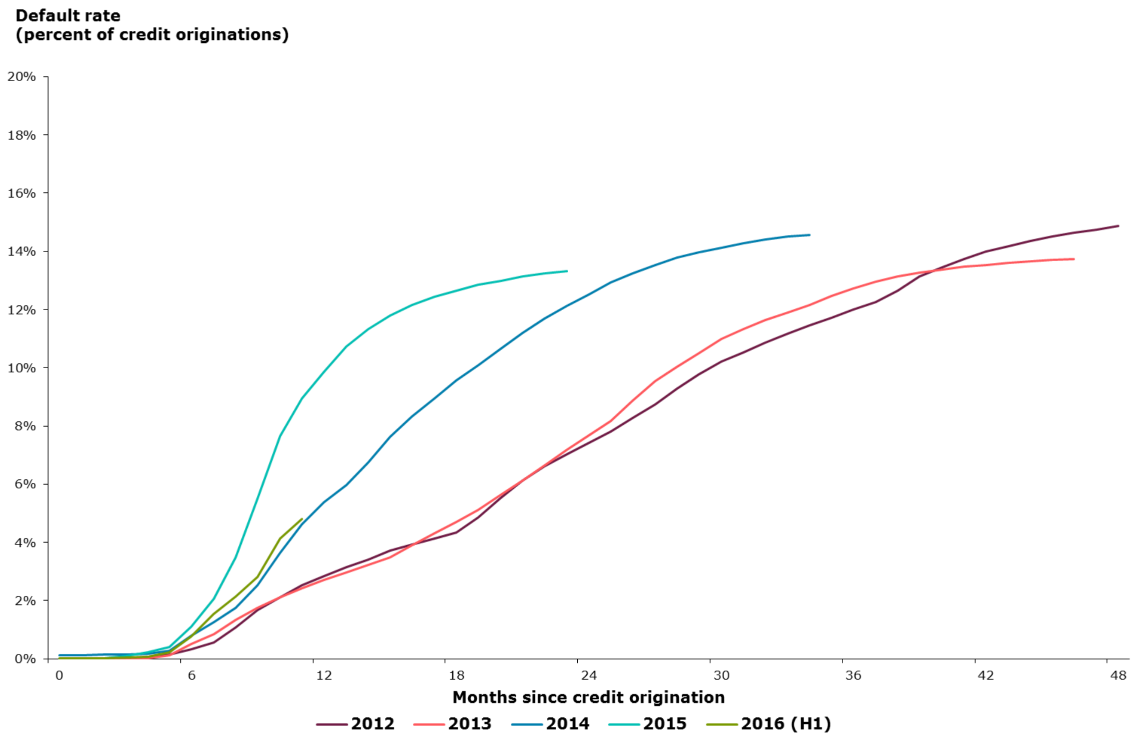
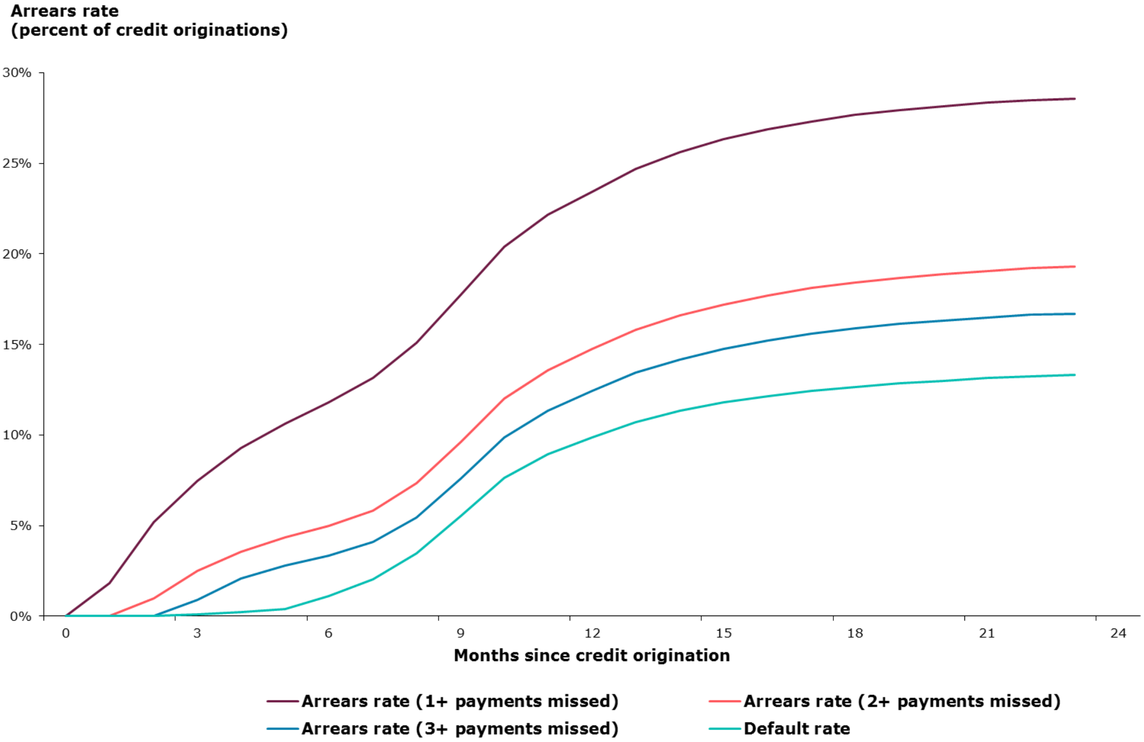


Figure 23: Default rates by vintage of catalogue credit origination (January 2012 – June 2016)



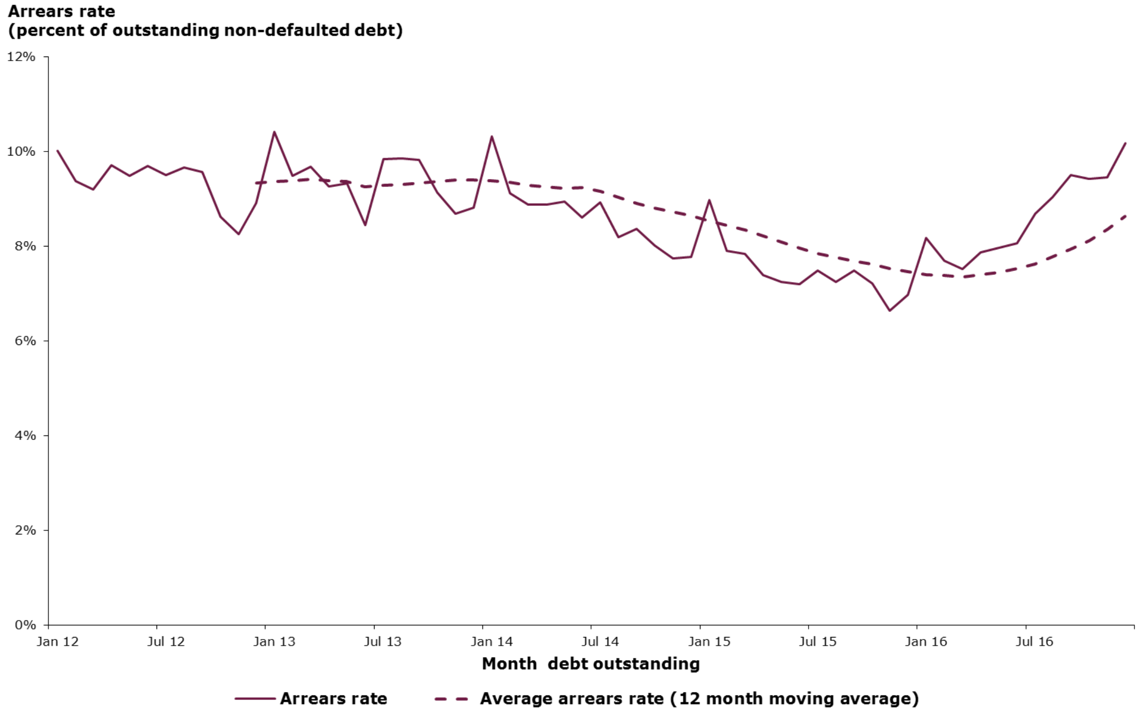
5.8 Figure 24 shows a variety of measures of delinquency rates for catalogue credit agreements issued in 2015. We observe that there is quite a large difference between the proportion of agreements who miss one payment and those who miss two (or more) payments. Approximately 70% of agreements where two or more payments have been missed eventually end up in default.

Figure 24: Stages of delinquency for 2015 catalogue credit origination vintage



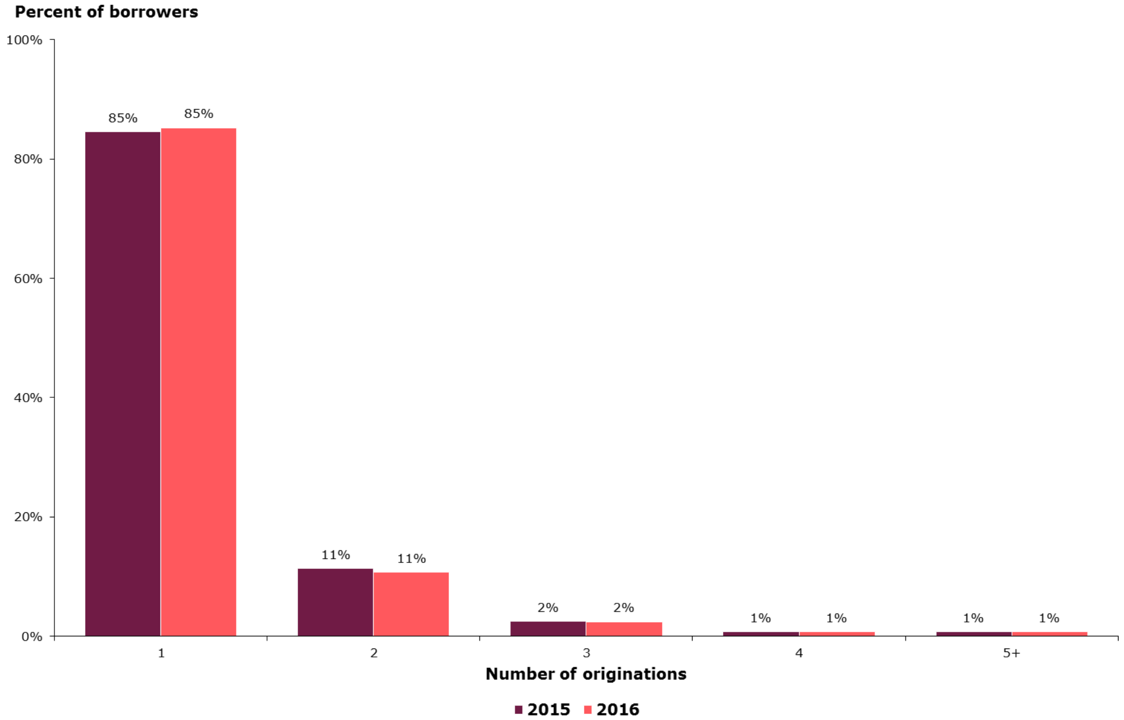
5.9 Figure 25 shows the proportion of the total stock of non-defaulted outstanding catalogue credit debt in arrears between 2012 and 2016. This averaged near 10% from 2012 to 2014 and then steadily declined to average under 7.5% by the end of 2015. It was increasing over the course of 2016 but remained below 10%. Given that the recent flow of originations has had lower delinquency rates, this overall increase in the stock of delinquencies is primarily driven by older catalogue credit agreements.

Figure 25: Outstanding stock of delinquent catalogue credit debt (January 2012 – December 2016)



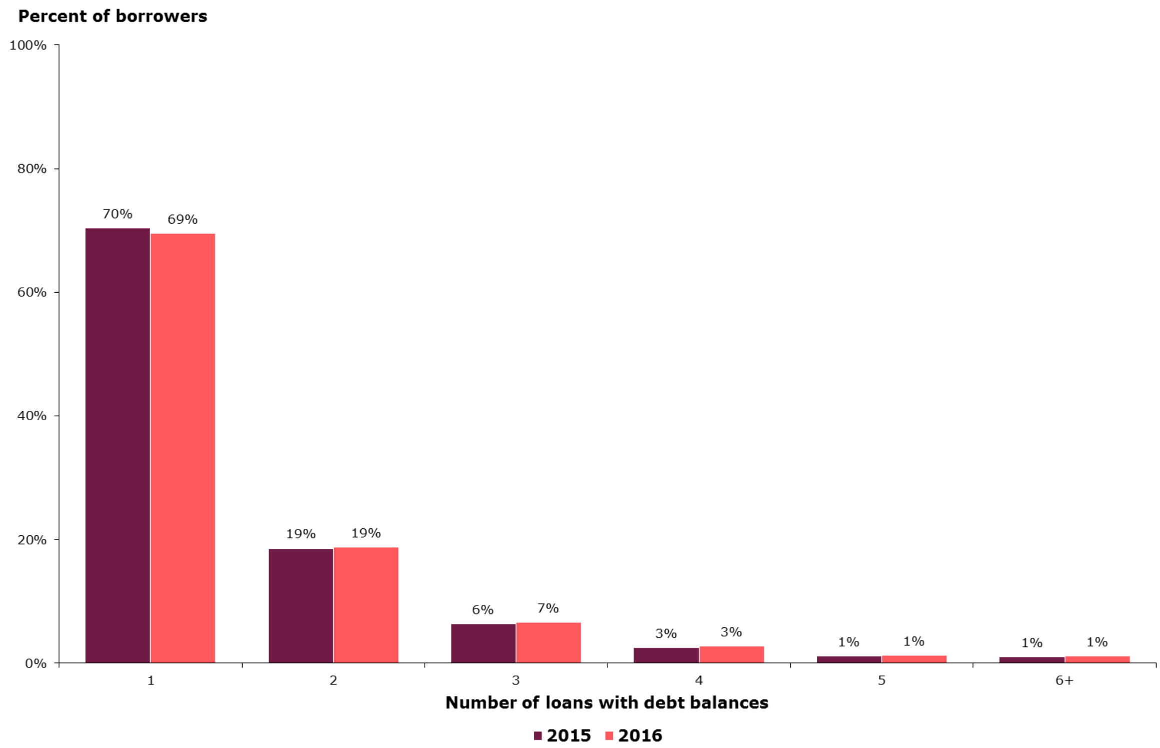
5.10 Examining the repeated use of catalogue credit shows that 85% of people taking out these products took out exactly one agreement during 2016. As shown in Figure 26 these have not changed between 2015 and 2016.

Figure 26: Distribution of catalogue credit originations per borrower (2015, 2016)



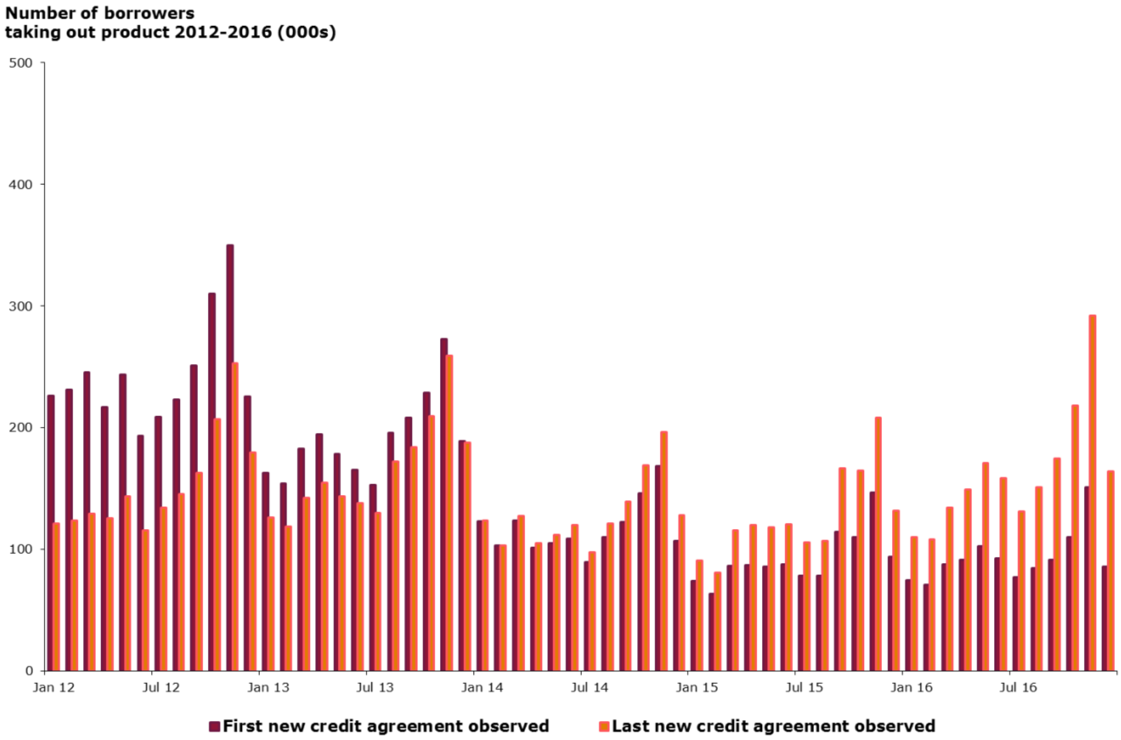
5.11 Figure 27 shows a similar pattern for the number of catalogue credit products these 2015 and 2016 users have outstanding debts on. 69-70% of these people have just one catalogue credit debt outstanding, 19% have two debts and 6-7% have three debts.

Figure 27: Distribution of number of catalogue credit agreements outstanding among borrowers with outstanding catalogue credit debt (2015, 2016)



5.12 Examining when people first and last took out a new catalogue credit agreement between 2012 and 2016 shows large seasonal spikes (Figure 28). Each October and November there are a significant cohort of catalogue credit customers first (or last) observed.

Figure 28: Date catalogue credit borrowers are first and last observed taking out a new catalogue credit agreement between January 2012 and November 2016



Consumer circumstances

5.13 Catalogue credit borrowers are typically older than many other users of products potentially considered as high-cost. They have a mean and median average age of 47 and 45 respectively. These borrowers also have fairly low incomes - estimated mean and median annual, net individual incomes are £22,300 and £17,700 respectively.[29] No income estimate is observed for 11% of consumers who took out catalogue credit agreements during 2016.

5.14 When we examine the credit score profile of people taking out catalogue credit agreements we observe that they have much higher scores than consumers of other less mainstream credit products. By comparison, former users of these products, who took out catalogue credit agreements in 2012, 2013 or 2014 but did not do so in 2015 or 2016, have even higher credit scores. This reflects a slight deterioration in the credit scores of 2016 catalogue credit borrowers and slight improvement in the credit scores of former borrowers. For 2016 borrowers we also observe a hump in the middle of the credit score distribution which is 'new-to-credit' borrowers who we observe often have little or no credit history. This is noticeably less present among former borrowers. These are displayed in Figure 29.

5.15 The median ratio of outstanding personal debt to estimated annual, net individual incomes (DTI ratio) similarly increase from 2% to 9% 2015 to 2017. Over this time mean average DTI ratio also increases from 21% to 28%. Figure 30 shows how former borrowers have lower DTI ratios than those taking out catalogue credit agreements in 2016.

[29] Not all consumers have income estimates. We treat these income estimates with caution as they are often not verified income but based on credit applications or estimates from current account flows. See FCA Occasional Paper 28 for more details on these.

Figure 29: Distribution of January 2017 credit score of 2016 catalogue credit borrowers and former catalogue credit borrowers (borrowing catalogue credit in 2012-2014 but not in 2015 or 2016), dotted line for mean

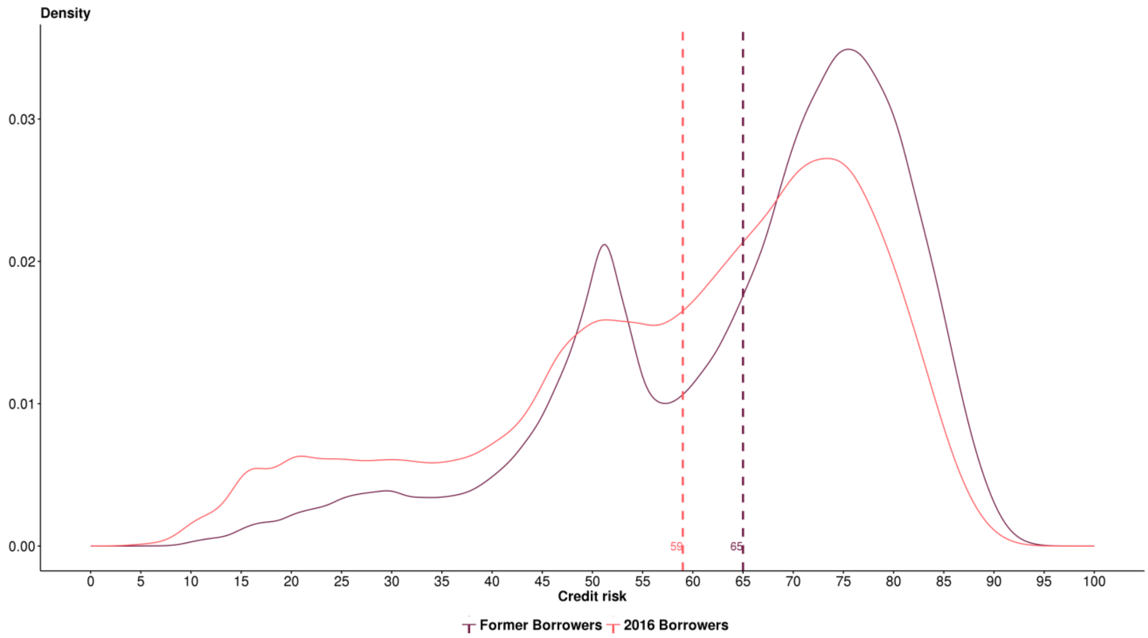
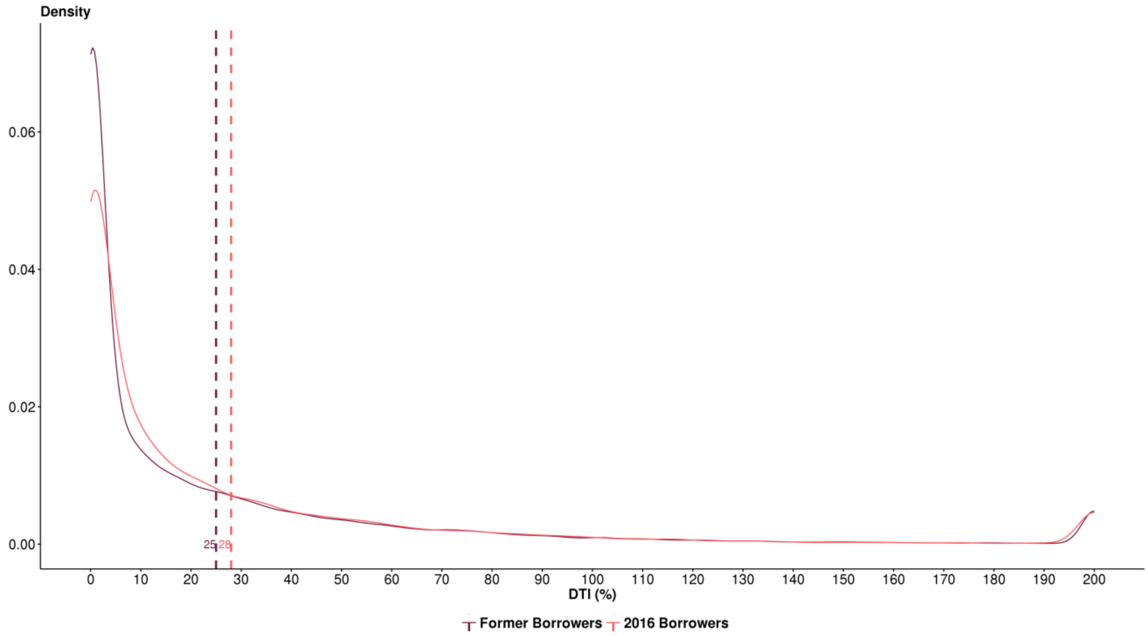


Figure 30: Distribution of January 2017 DTI ratio of 2016 catalogue credit borrowers and former catalogue credit borrowers (borrowing catalogue credit in 2012-2014 but not in 2015 or 2016) , dotted line for mean



5.16 Table 9 shows the debts of 2016 borrowers as of November 2014. This shows that approximately 40% of people who would go on to take out a catalogue credit agreement in 2016 had no outstanding personal debt. By November 2016, just over 25% of borrowers still had no outstanding personal debt. The borrower with the median amount of outstanding debt increased from £300 to £1,300 November 2014 to November 2016. When we order these same people by their outstanding debts we observe that the top 25% of borrowers had at least £2,900 in debt in November 2014 compared to at least £5,600 by November 2016.

5.17 Among consumers taking out catalogue credit agreements during 2016 the median consumer had two credit items (any form of personal debt) with outstanding debt as of November 2016. The top 10% of people had outstanding personal debt on eight or more products – up from five two years' prior to this.

5.18 Table 9 shows the composition of debts held by these people. It reveals that one in five catalogue credit borrowers also had outstanding mortgage debt. 30% of people had outstanding catalogue credit debt in November 2015 and 57% still did by November 2016. Over a third of these people held credit card debts in November 2015 and this increases to 40% one year on. Overdraft and unsecured personal loan debts are also fairly commonly held as is telecommunications debt. It is quite rare for these people to hold home credit or rent-to-own debt.

Table 9: Products held by borrowers taking out at least one catalogue credit agreement between December 2015 and November 2016

	Percent of catalogue credit borrowers also holding debt on product as of…	
Product name	**November 2015**	**November 2016**
Catalogue credit	30%	57%
Credit card	34%	40%
Overdraft	20%	22%
Telecommunications	20%	20%
Mortgage	20%	20%
Unsecured personal loan	14%	18%
Retail finance	10%	12%
Motor finance	7%	9%
Home credit	7%	8%
Other household bills	7%	8%
High-cost short-term credit (HCSTC)	5%	7%
Store card	6%	7%
Rent-to-own	2%	2%
Other running account	1%	1%
Guarantor loan	<1%	1%
Logbook loan	<1%	<1%
Charge card	<1%	<1%

5.19 Figure 31 shows the share of personal debt balances of catalogue credit customers that these different products account for. Catalogue credit is a relatively small proportion of these people's personal debt – 7% increasing to 9% from November 2015 to November 2016. Over 50% of these people's debts are in credit cards or motor finance. Another 20% is in unsecured personal loan debt while overdraft debt accounts for a relatively small proportion – 5%.

5.20 Finally, we examine the other new originations catalogue credit borrowers take out between December 2015 and November 2016 (Figure 32). Just over one in five borrowers take out a new credit card and one in eleven a new current account. Relatively few people take out other new credit agreements.

Figure 31: Share of outstanding personal debt of catalogue credit borrowers (December 2015 – November 2016) as of November 2015 and November 2016

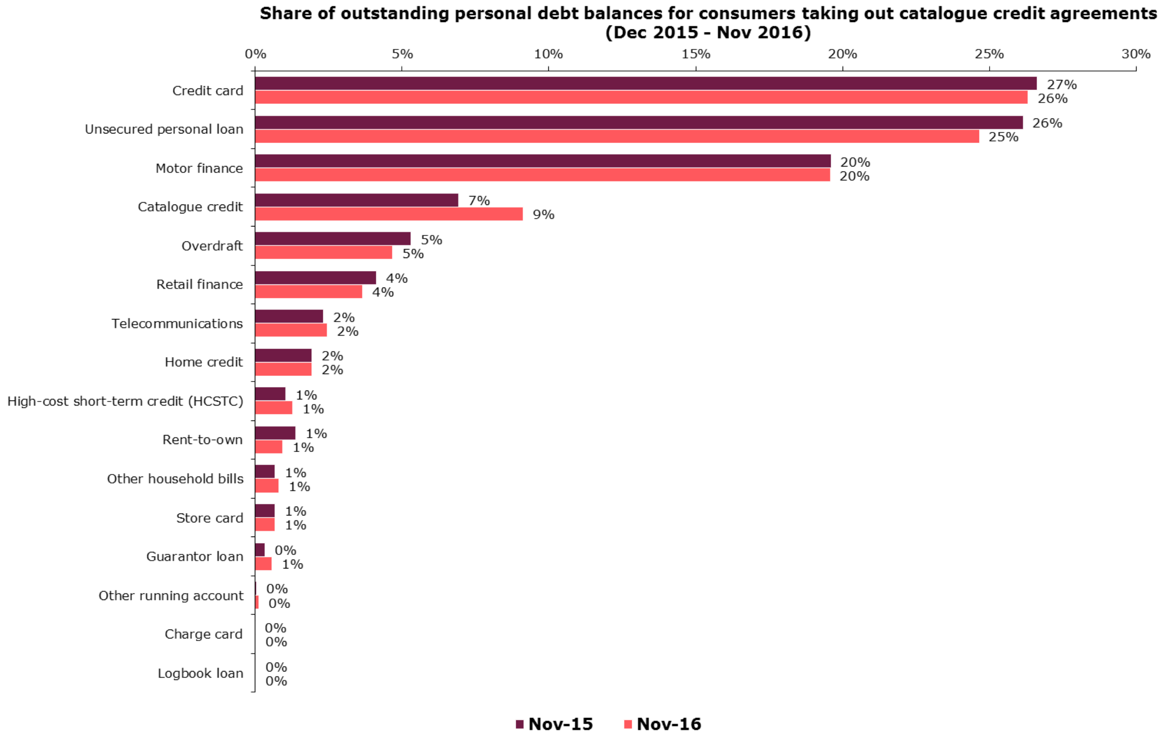
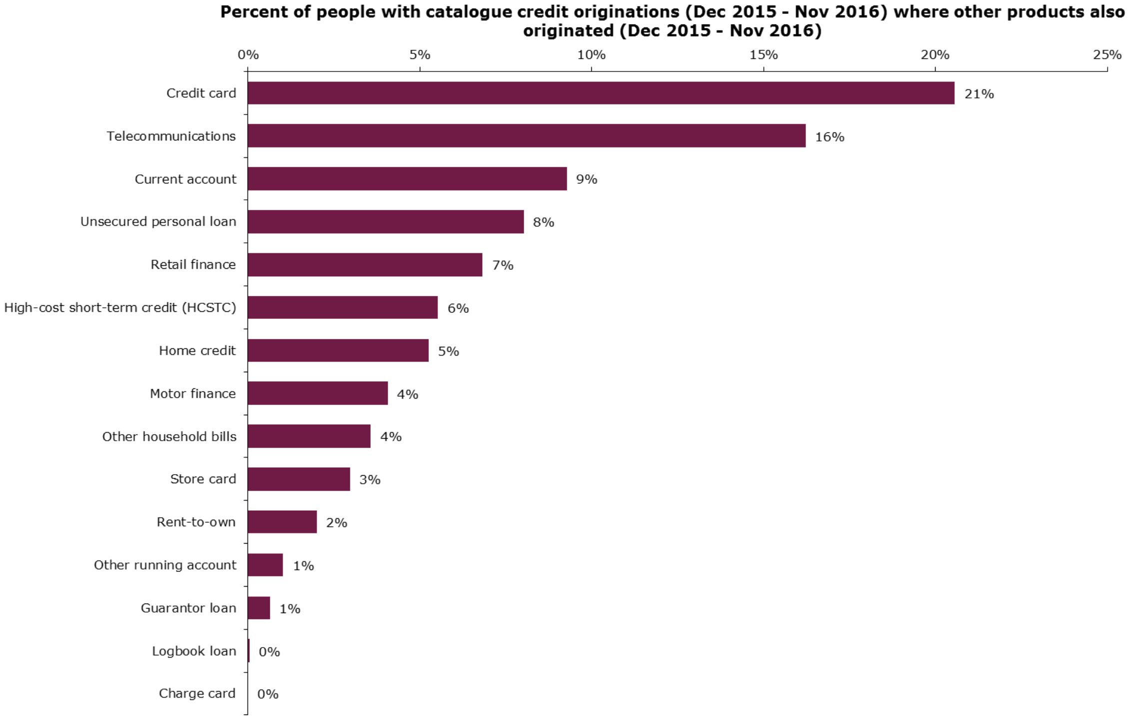


Figure 32: Products originated by catalogue credit borrowers (December 2015 – November 2016)

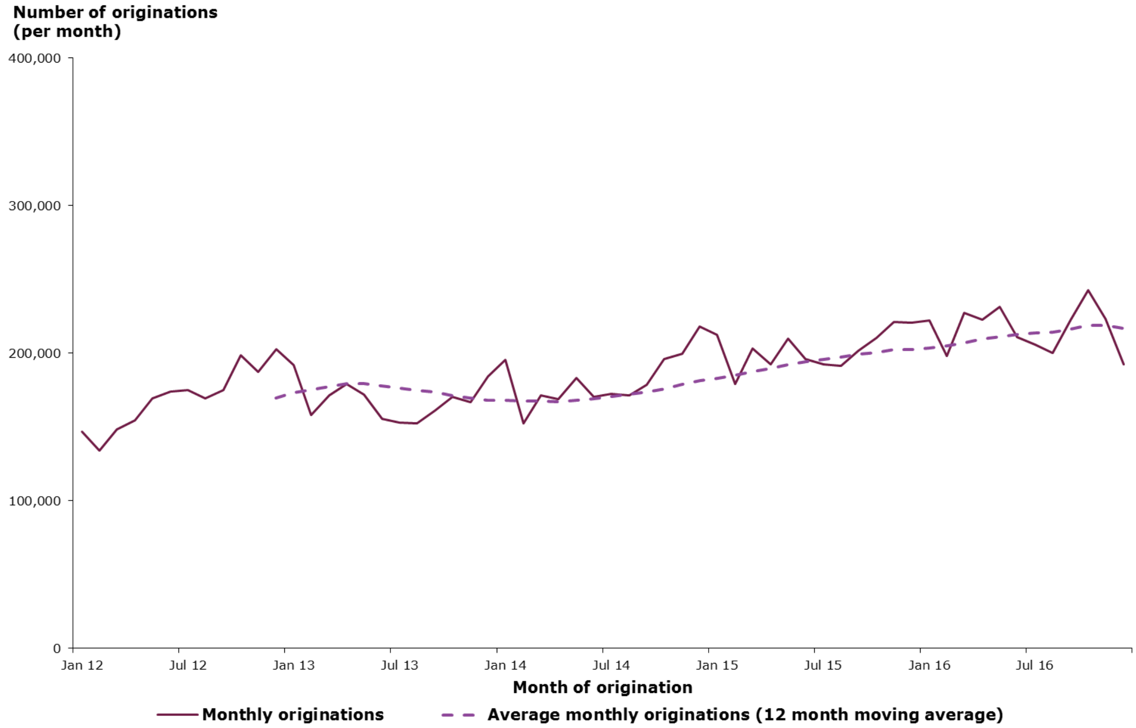


6 Retail finance

Market size

6.1 Retail finance agreements are when credit is provided to purchase a good or service at a particular retailer and the agreement is due to be repaid over a number of instalments.[30] During 2016, the retail finance market had approximately 215,000 new agreements taken out per month on average. Figure 33 displays that this market has much less noticeable seasonal variation than some other markets – such as the catalogue credit market.

Figure 33: Number of retail finance originations (January 2012 – December 2016)



6.2 In 2016, 2.3 million people took out retail finance which is an increase on earlier years representing growth relative to 2014 or 2015 where 1.9 and. 2.1 million people respectively took out these products as is presented in Table 10.

6.3 5.3 million people had outstanding retail finance debt at the end of 2016 which is more than double the number of people taking out new retail finance agreements during that year. This is increasing over time from 4.5 million in 2014 to 4.9 million in 2015. Between 2012 and 2016 8.5 million people held debt on these products.

6.4 In 2016, both the number and value of retail finance originations were higher than previous years with steady increases since 2012. Throughout this time the average (mean) origination amount remained above £1,700. The £6.0bn value of total outstanding retail finance debt at the end of 2016 is also greater than had been in previous years - £5.5bn and £5.8 in 2014 and 2015 respectively. The overall growth

[30] This is a catch-all category covering borrower-lender-supplier agreements other than rent-to-own, motor finance, store cards and catalogue credit.

in the stock of outstanding debt is mainly driven by steadily increasing flows of new lending as opposed to growing values of existing retail finance agreements.

Table 10: Size of retail finance market (2012 – 2016)

	Number of consumers taking out product (millions)	**Average (mean) value of originations**	**Number of originations (millions)**	**Value of originations (billions)**	**Value of outstanding debt (billions)**
2012	1.8	£1,770	2.0	£3.6	£4.9
2013	1.8	£1,930	2.0	£3.9	£5.2
2014	1.9	£1,960	2.2	£4.3	£5.6
2015	2.1	£1,790	2.4	£4.4	£5.8
2016	2.3	£1,690	2.6	£4.4	£6.0

Credit performance

6.5 Over time there has been a steady and noticeable decline in the proportion of retail finance agreements which became delinquent (Figure 34). The arrears rates on new vintages of lending have decreased from over 6% of agreements to 3% from 2012 to 2016. These arrears rates are much lower than observed on other less mainstream products.

6.6 Figure 35 shows the proportion of new retail finance agreements entering default has followed a similar pattern declining over time from near 2% to 0.5% (or lower).

6.7 Other measures of stages of delinquencies shown in Figure 36 follow similar patterns to arrears and default rates. Approximately a quarter of 2015 retail finance agreements missing two or more payments eventually ended up in default but this increases to closer to 50% on older 2012 or 2013 vintages.

Figure 34: Arrears rates by vintage of retail finance origination (January 2012 – June 2016)

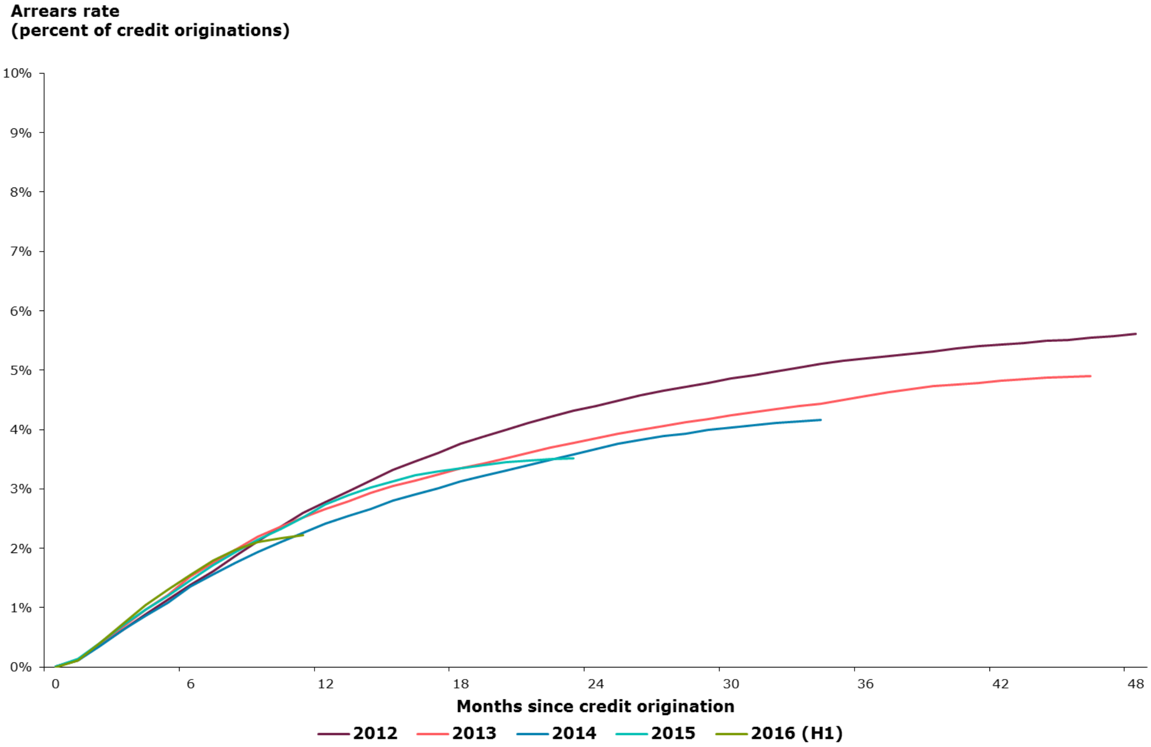


Figure 35: Default rates by vintage of retail finance origination (January 2012 – June 2016)

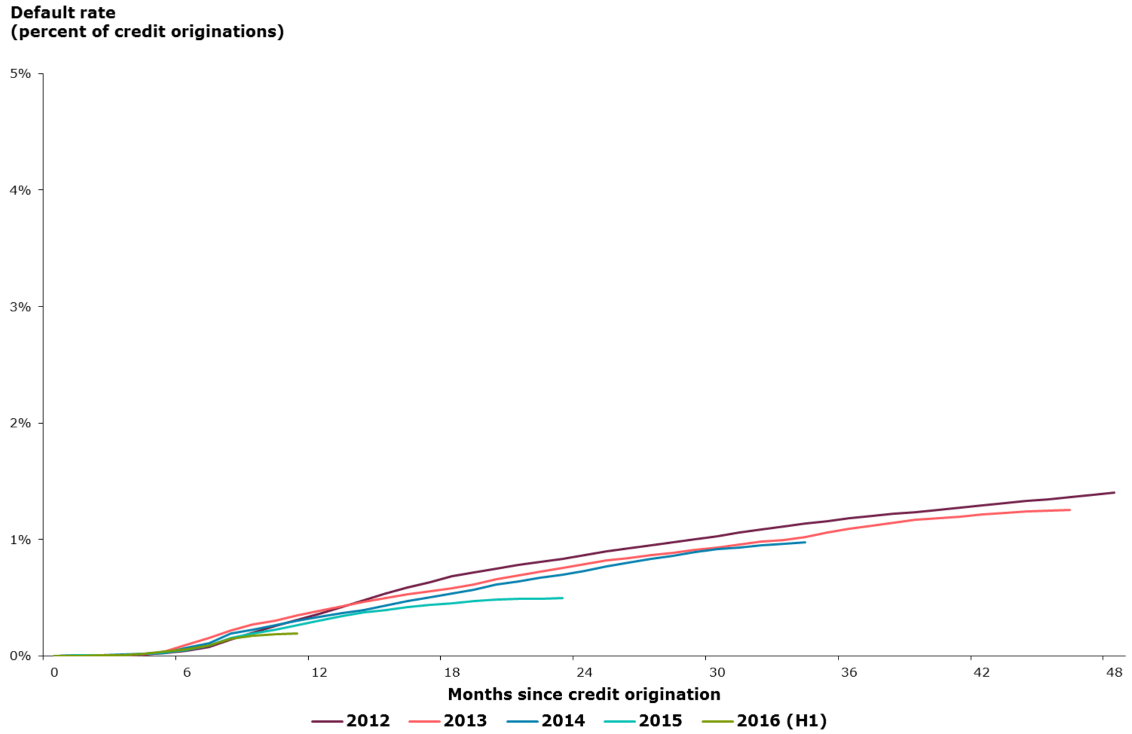
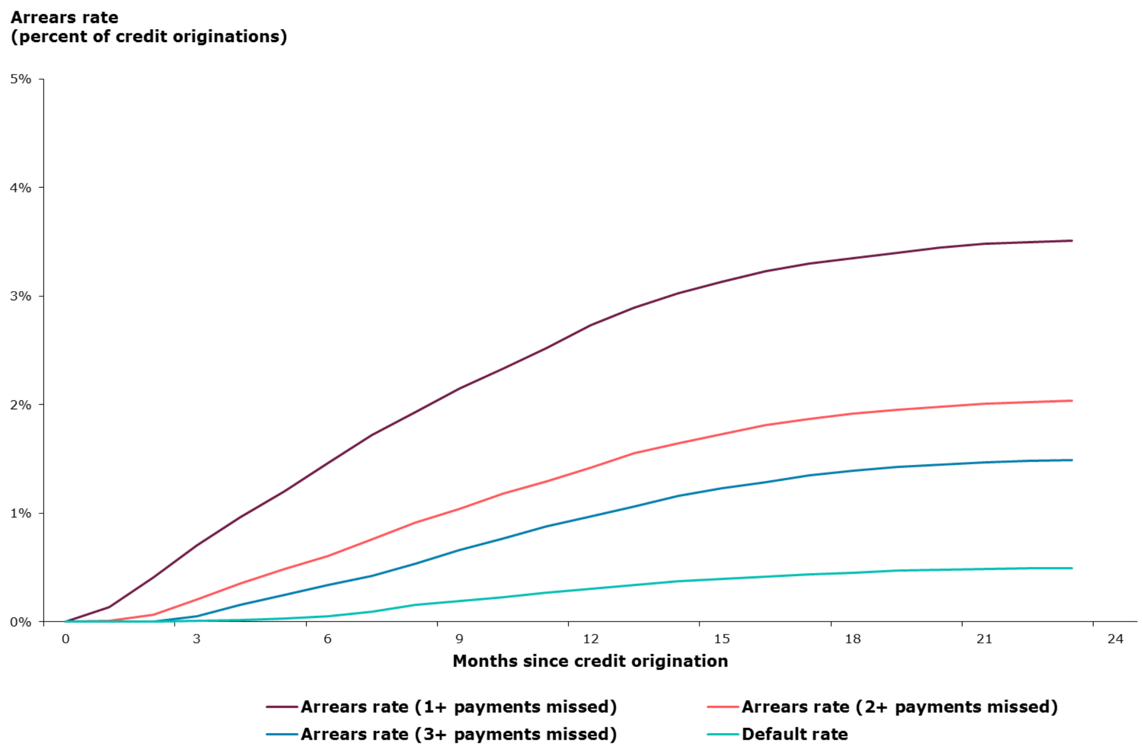
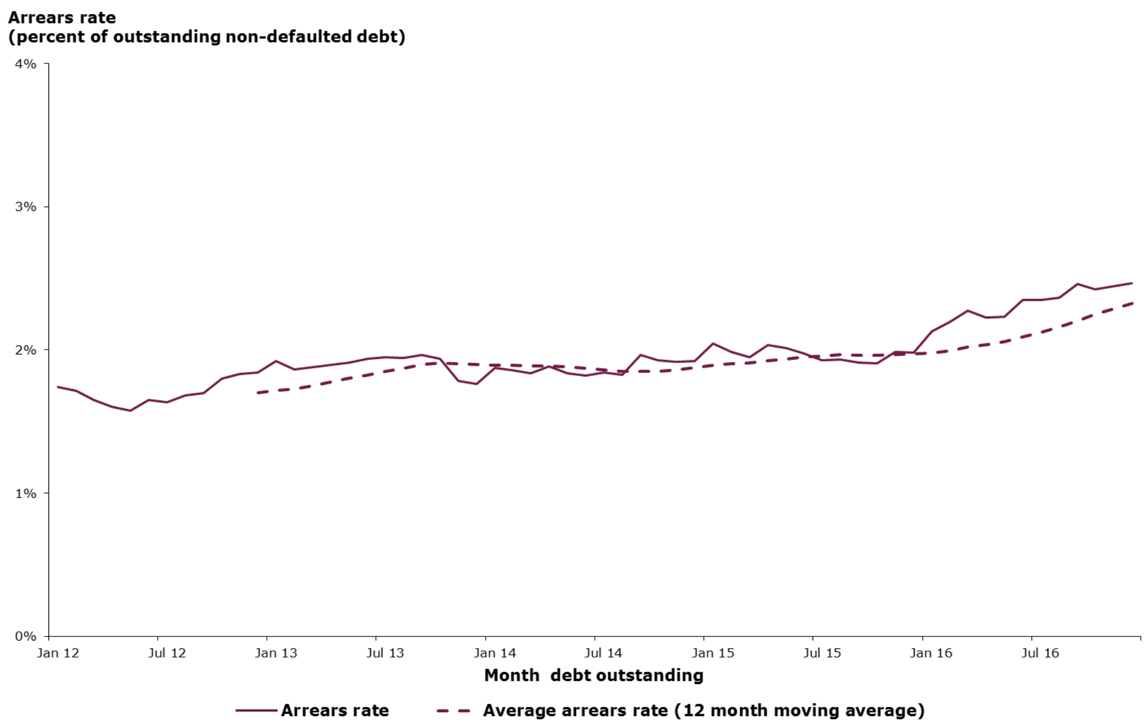


Figure 36: Stages of delinquency for 2015 retail finance origination vintage



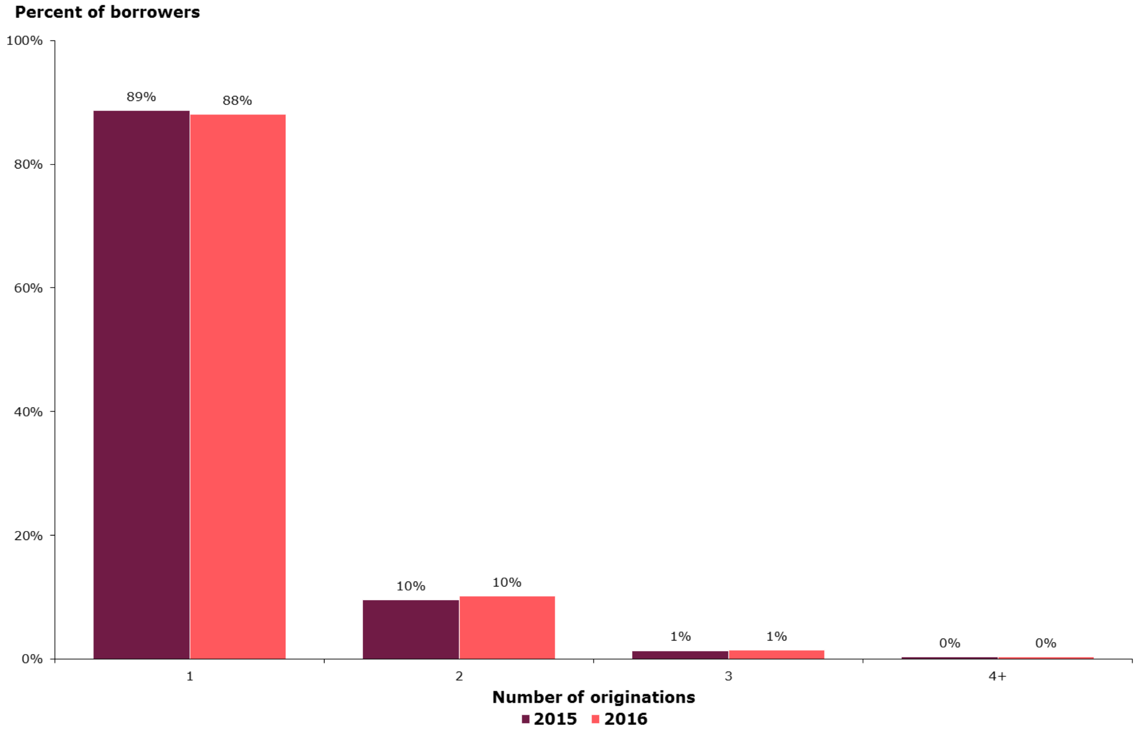
6.8 In line with the lower arrears and default rates on this product compared to most of the other less mainstream credit products, the proportion of the total stock of outstanding, non-defaulted retail finance debt in arrears is also lower. Figure 37 shows that towards the end of 2016 approximately 2% of debt was delinquent.

Figure 37: Outstanding stock of delinquent retail finance agreements (January 2012 – December 2016)



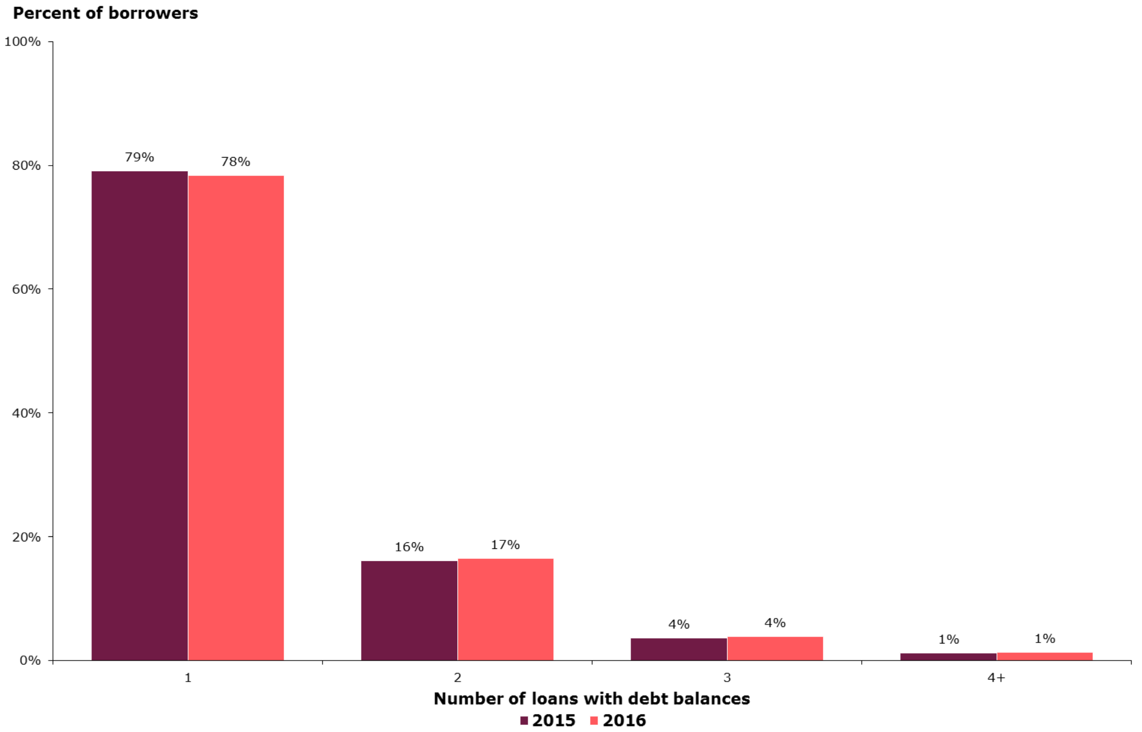
6.9 Examining the repeated use of retail finance agreements by consumers shows that almost 90% of people taking out these products took out exactly one agreement during 2016. As shown in Figure 38 this has barely changed between 2015 and 2016.

Figure 38: Distribution of retail finance agreements per borrower (2015, 2016)



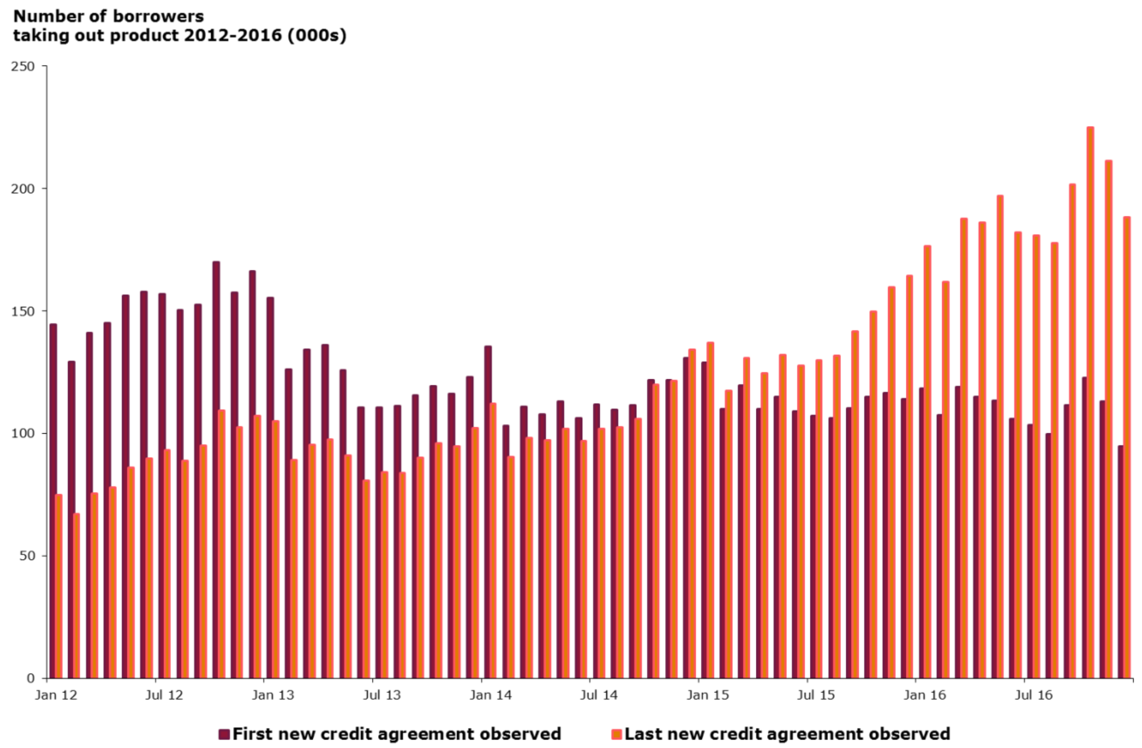
6.10 Comparing these to the number of retail finance products these users have outstanding debts on - in Figure 39 - shows a similar overall pattern but different proportions. There is little difference between 2015 and 2016 figures. Almost 80% of these people have a single retail finance debt outstanding and 5% have three or more.

Figure 39: Distribution of number of retail finance agreements outstanding among borrowers with outstanding retail finance debt (2015, 2016)



6.11 Figure 40 shows the first and last date we observe consumers taking out a new retail finance agreement between 2012 and 2016. We observe that the number of new borrowers is fairly flat after 2013 indicating a steady stream of new customers to this market. Unlike some other products we observe relatively little seasonality.

Figure 40: Date retail finance borrowers are first and last observed taking out a new retail finance agreement between January 2012 and November 2016



Consumer circumstances

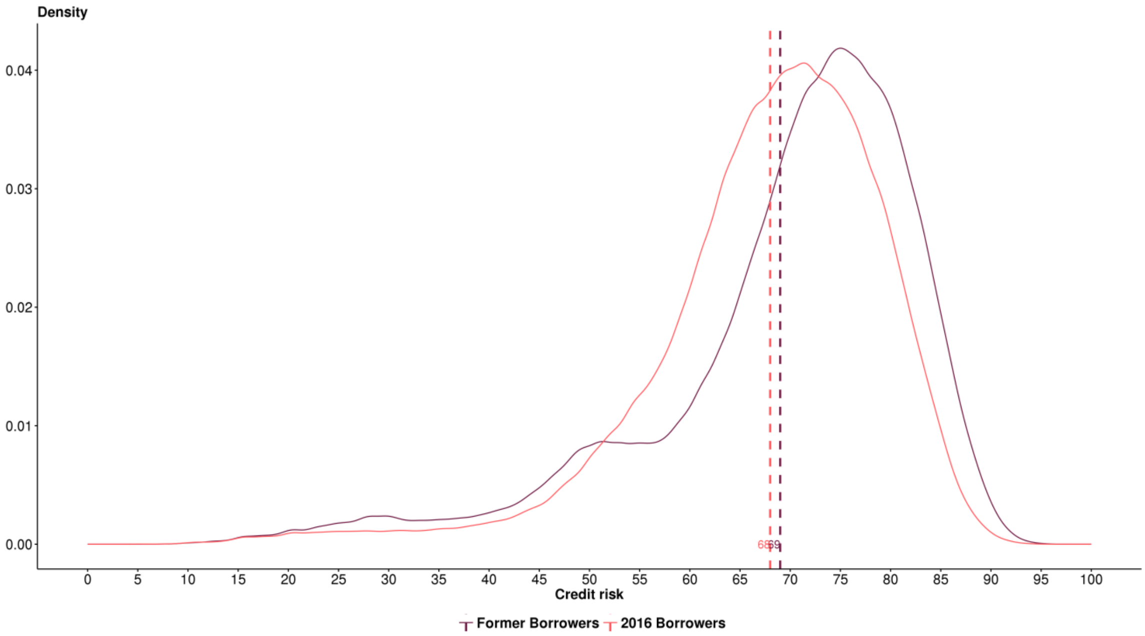
6.12 Retail finance borrowers are typically in their forties with a mean and median average age of 42 and 41 respectively. These borrowers also have much higher incomes than many of the other products examined - estimated mean and median annual, net individual incomes are £31,900 and £24,700 respectively.[31]

6.13 When we examine the credit score profile of people taking out retail finance agreements we observe that they have noticeably higher scores than consumers of other less mainstream credit products. Former users of these products, who took out retail finance agreements in 2012, 2013 or 2014 but did not do so in 2015 or 2016, have even higher credit scores. These are displayed in Figure 41.

6.14 Examining the debts of 2016 borrowers displays that as of November 2014, over 30% of people who would go on to take out a retail finance agreement in 2016 had no outstanding personal debt. By November 2016, fewer than 10% of these borrowers had no outstanding personal debt and therefore had taken out and repaid at least one retail finance agreement during this time. The borrower with median amount of outstanding debt more than quadrupled from £1,200 to £4,300 November 2014 to November 2016. This reflects that retail finance agreements are often large in size and are repaid over multiple instalments which can last multiple years. When we order these same people taking out retail finance agreements by their outstanding debts we observe that the top 25% of borrowers had at least £8,100 in debt in November 2014 compared to at least £12,500 by November 2016.

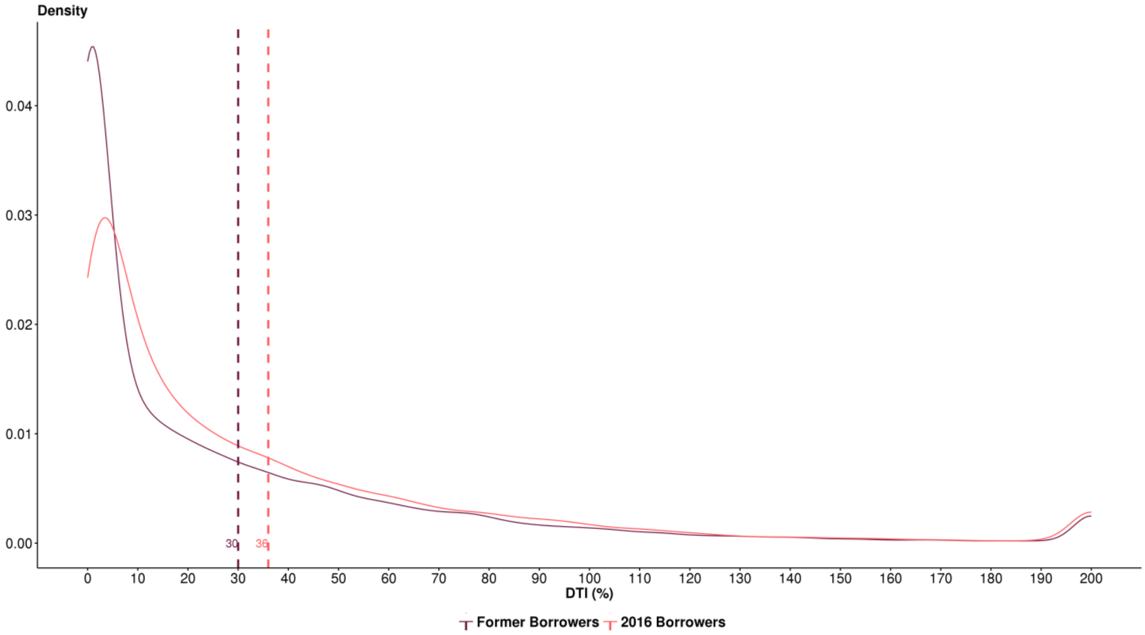
6.15 The median ratio of outstanding personal debt to estimated annual, net individual incomes (DTI ratio) similarly increases from 6% to 19% between January 2015 and January 2017. Figure 42 displays the distribution of the DTI ratio for these people compared to former borrowers who took out at least one retail finance agreement in 2012, 2013 or 2014 but not in 2015 or 2016.

Figure 41: January 2017 credit score of 2016 retail finance borrowers and former retail finance borrowers (borrowing retail finance in 2012-2014 but not in 2015 or 2016), dotted line for mean



[31] We do not observe income estimates for 2% of people.

Figure 42: Distribution of January 2017 DTI ratio of 2016 retail finance borrowers and former retail finance borrowers (borrowing retail finance in 2012-2014 but not in 2015 or 2016) , dotted line for mean



6.16 Among consumers taking out retail finance agreements during 2016 the median number of credit items (any form of personal debt) with outstanding debt on in November 2016 was three – up from two in November 2014. The top 10% of people had outstanding personal debt on six or more products – up from five two years' prior to this.

6.17 We examine the composition of the debts held by borrowers taking out at least one retail finance agreement in a 12 month period in Table 11. 28% of these people had retail finance debt in November 2015 and 88% still did so in November 2016. This reflects that retail finance agreements are typically not used for short-term borrowing.

6.18 It is very common for these consumers to have mortgage or credit card debts with over 40% having either of these products. Approximately a quarter hold unsecured personal loans and just fewer than 20% have overdrafts. Motor finance and catalogue credit are also fairly commonly held by these people. From 2015 to 2016 most of these products show slight increases in the proportion of people with outstanding debts of such products.

Table 11: Products held by borrowers taking out at least one retail finance agreement between December 2015 and November 2016

	Percent of retail finance borrowers also holding debt on product as of…	
Product name	**November 2015**	**November 2016**
Retail finance	28%	88%
Mortgage	43%	46%
Credit card	42%	45%
Unsecured personal loan	25%	28%
Overdraft	18%	19%
Motor finance	16%	19%
Catalogue credit	14%	16%
Telecommunications	16%	13%
Store card	6%	7%
Other household bills	5%	5%
High-cost short-term credit (HCSTC)	1%	1%
Other running account	<1%	1%
Home credit	1%	1%
Rent-to-own	<1%	<1%
Guarantor loan	<1%	<1%
Charge card	<1%	<1%
Logbook loan	<1%	<1%

6.19 Looking at the share of overall debt balances of these people shows that these are highly concentrated among a small number of products (Figure 43). Retail finance accounts for a small minority, 6%, of these people's debts as of November 2015 but this markedly increases to 17% in November 2016.

6.20 The majority of these people's debts in November 2015 are held in three products – unsecured personal loans, motor finance and credit cards. Unsecured personal loans and motor finance each account for near 30% of these people's debts and credit cards near a quarter. By November 2016 these account for a smaller share of overall personal debt as the share of retail finance debt greatly increases.

6.21 Finally, examining the other debts of retail finance borrowers took out between December 2015 and November 2016 shows that over one in five took out a new credit card and one in seven a new unsecured personal loan. Around one in ten took out a new current account or motor finance agreement. These are displayed in Figure 44.

Figure 43: Share of outstanding personal debt of retail finance borrowers (December 2015 – November 2016) as of November 2015 and November 2016

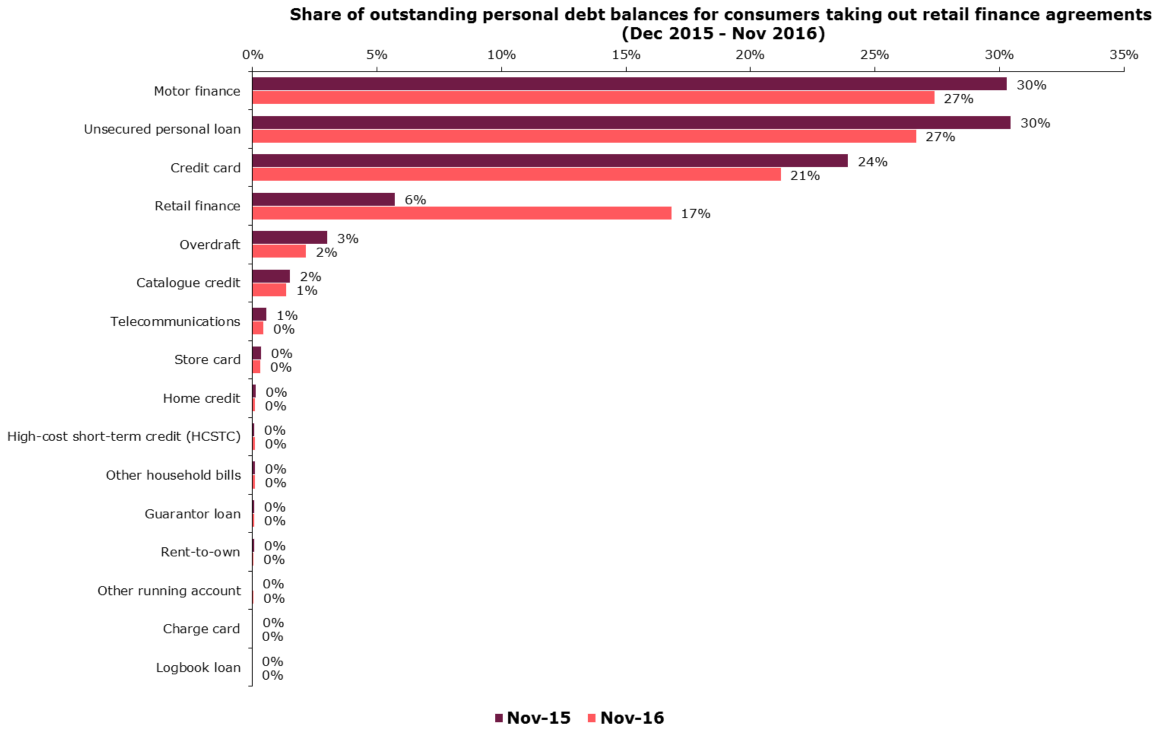
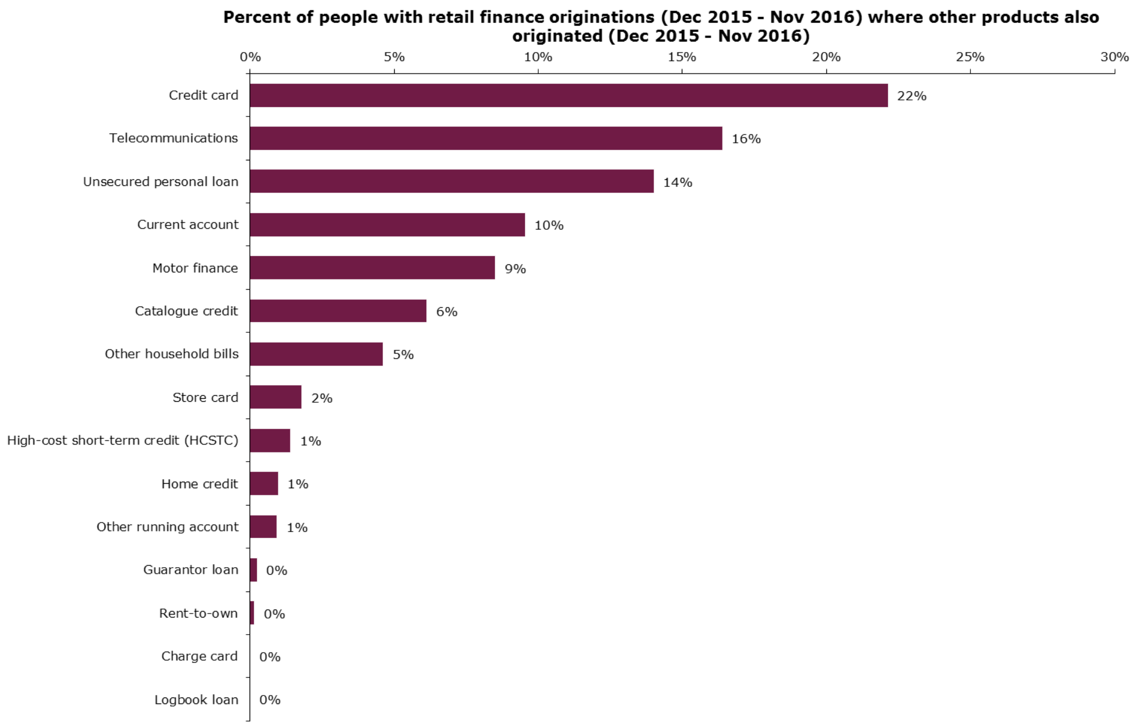


Figure 44: Products originated by retail finance borrowers (December 2015 – November 2016)

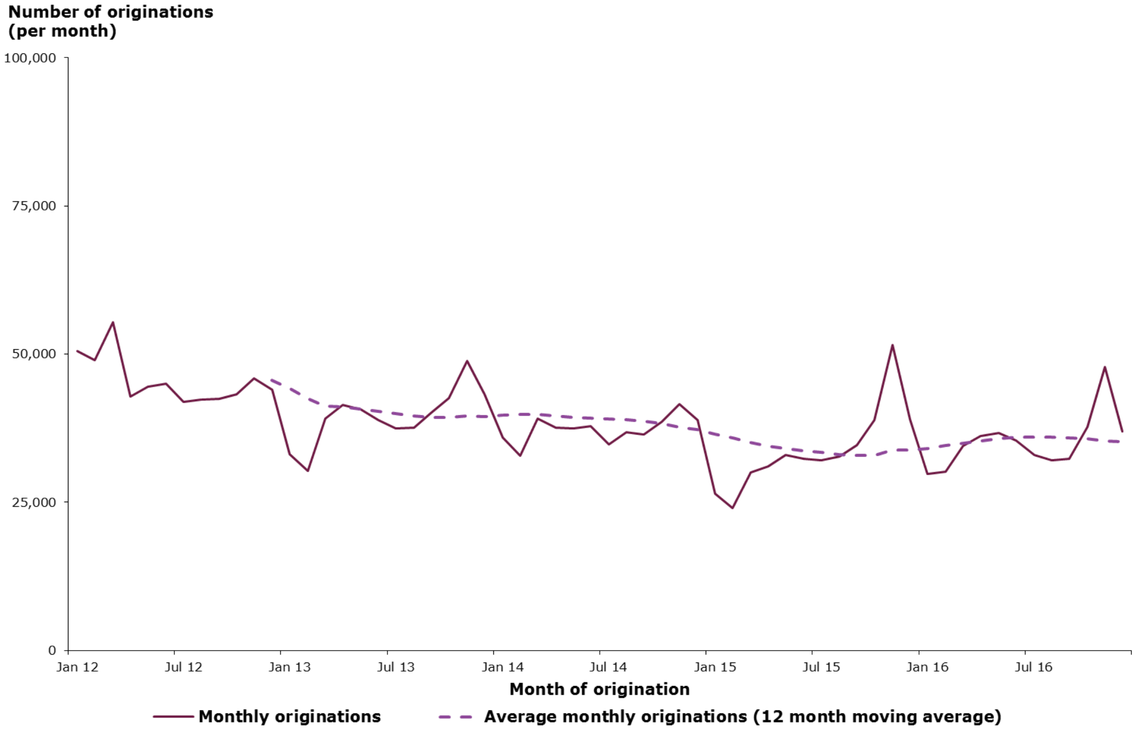


7 Store cards

Market size

7.1 Store cards are similar to credit cards except they can only be used at particular retailers. During 2016, the store card market had approximately 35,000 new agreements taken out per month on average. Figure 45 displays the number of new store card originations between 2012 and 2016.

Figure 45: Number of store card originations (January 2012 – December 2016)



7.2 In 2016, 0.4 million people took out a store card which is relatively unchanged over the last few years as presented in Table 12.

7.3 1.9 million people had outstanding store card debt at the end of 2016 which is more than four times the number of people taking out new store cards during that year.

7.4 In 2016, both the number and value of store card originations were similar to 2014 and 2015 but slightly down on 2012 and 2013. Throughout this time the average (mean) origination amount remained between £500 and £600. The £0.7bn value of total outstanding store card debt at the end of 2016 is slightly higher than previous years.

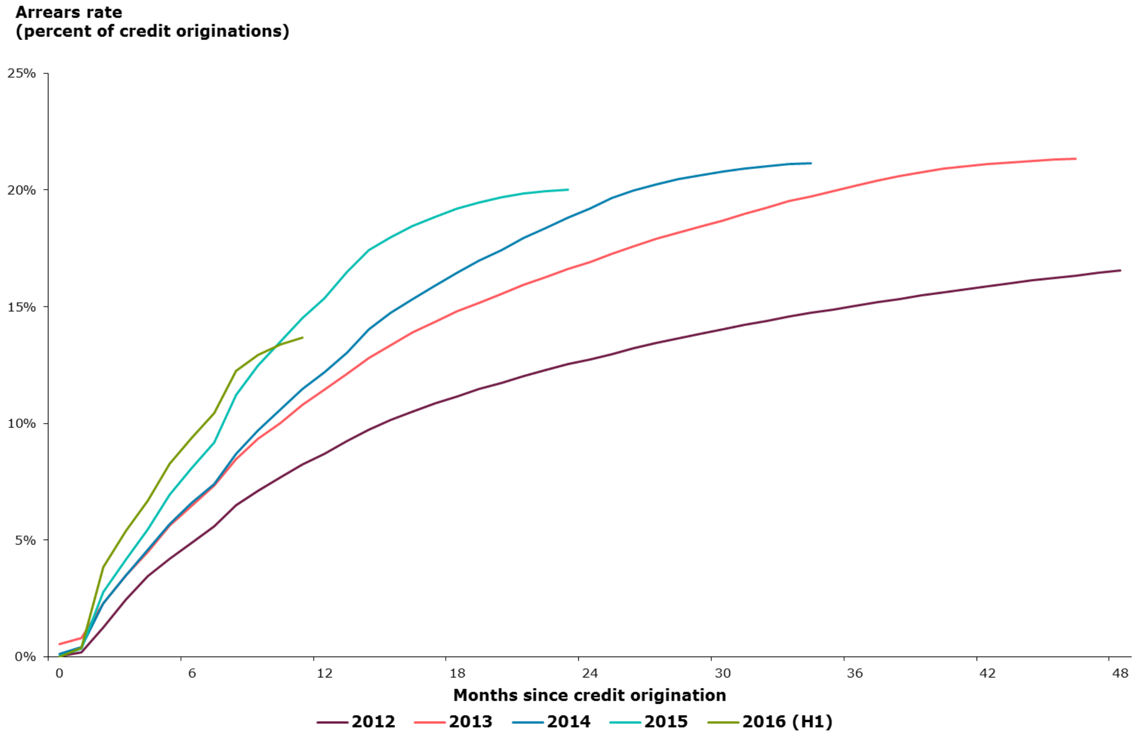
Table 12: Size of store card market (2012 – 2016)

	Number of consumers taking out product (millions)	Average (mean) value of originations	Number of originations (millions)	Value of originations (billions)	Value of outstanding debt (billions)
2012	0.5	£530	0.5	£0.3	£0.5
2013	0.5	£560	0.5	£0.3	£0.5
2014	0.4	£530	0.4	£0.2	£0.6
2015	0.4	£540	0.4	£0.2	£0.6
2016	0.4	£570	0.4	£0.2	£0.7

Credit performance

7.5 Figure 46 displays that the proportion of store cards entering arrears (missing at least one payment) remained near 20% for vintages of cards originated between 2013 and 2015. Data from store cards issued during the first half of 2016 appears to be following a similar pattern to the 2015 vintage.

Figure 46: Arrears rates by vintage of store card origination (January 2012 – June 2016)



7.6 Figure 47 shows that the proportion of new store card agreements entering default has followed a similar pattern between 2013 and 2015 - remaining near 5%. Other measures of delinquencies shown in Figure 48 follow a similar pattern to default rates. This shows how it is relatively common for store cards to miss one payment but much less common to miss more than one payment. Approximately 60% of cards which miss two or more payments eventually end up in default.

Figure 47: Default rates by store card originations (January 2012 – June 2016)

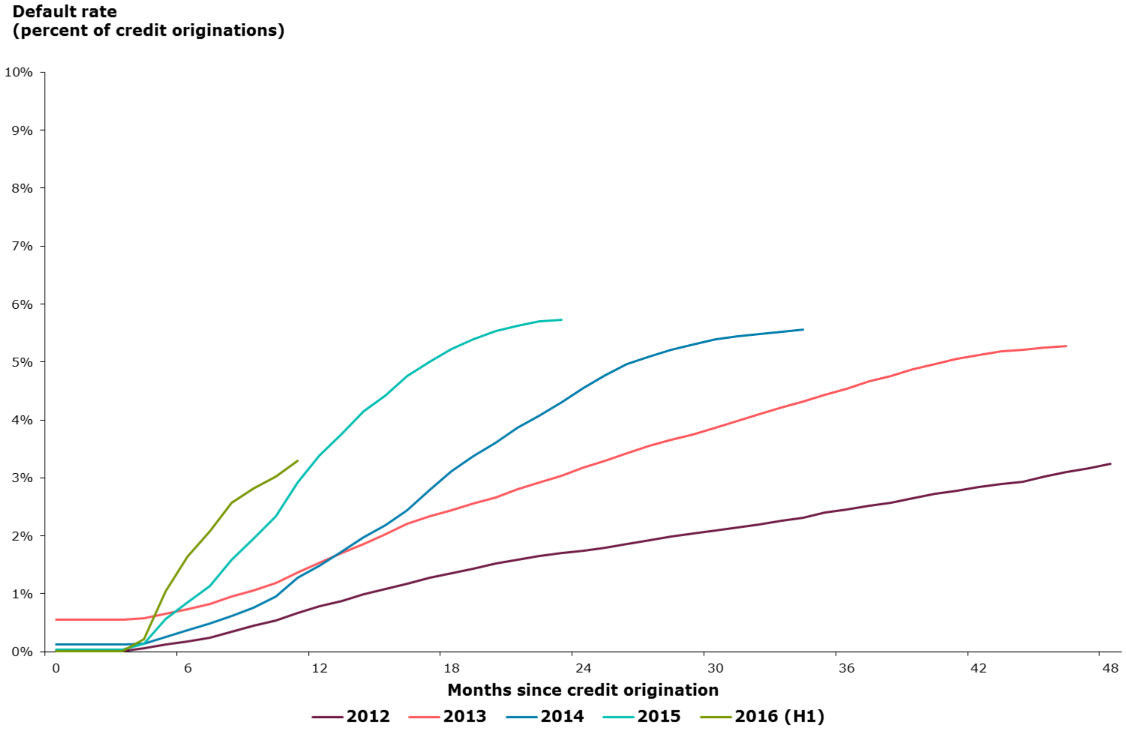
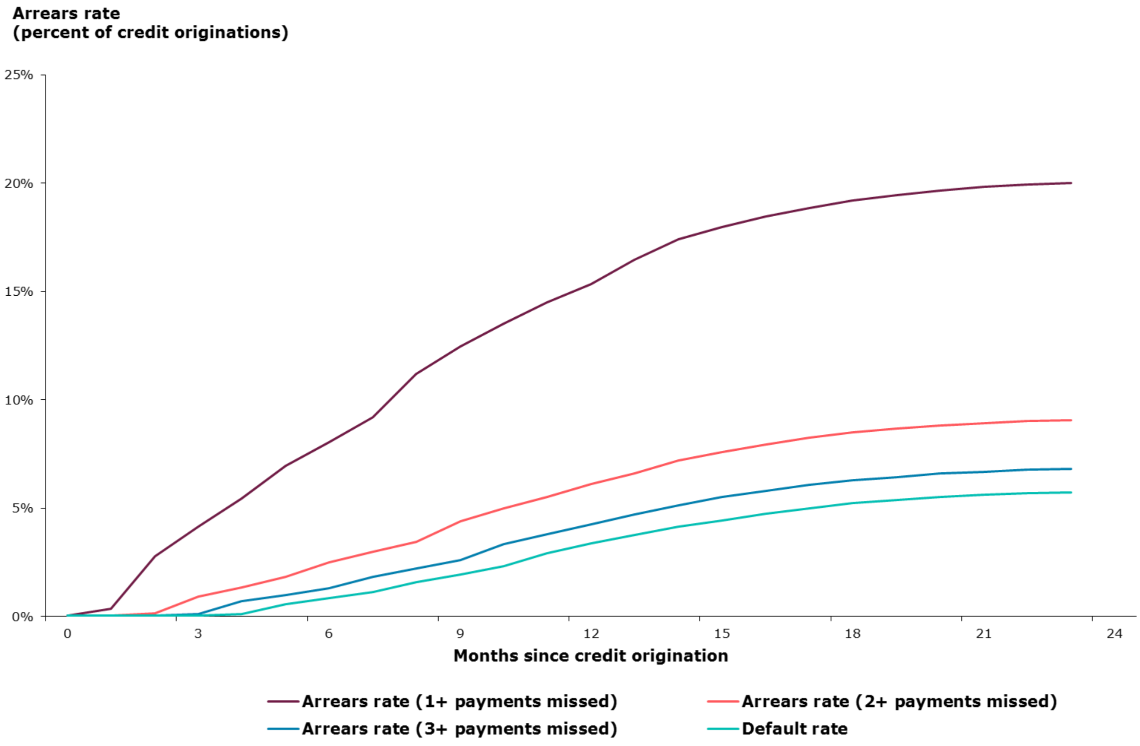
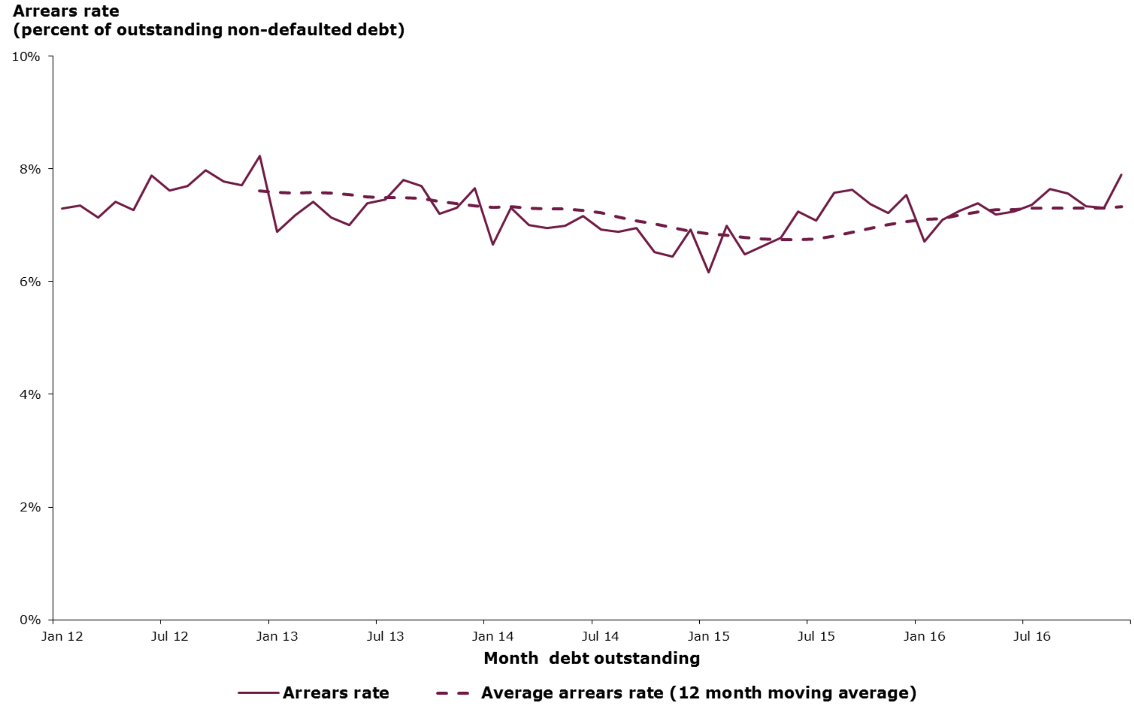


Figure 48: Stages of delinquency for 2015 store card originations



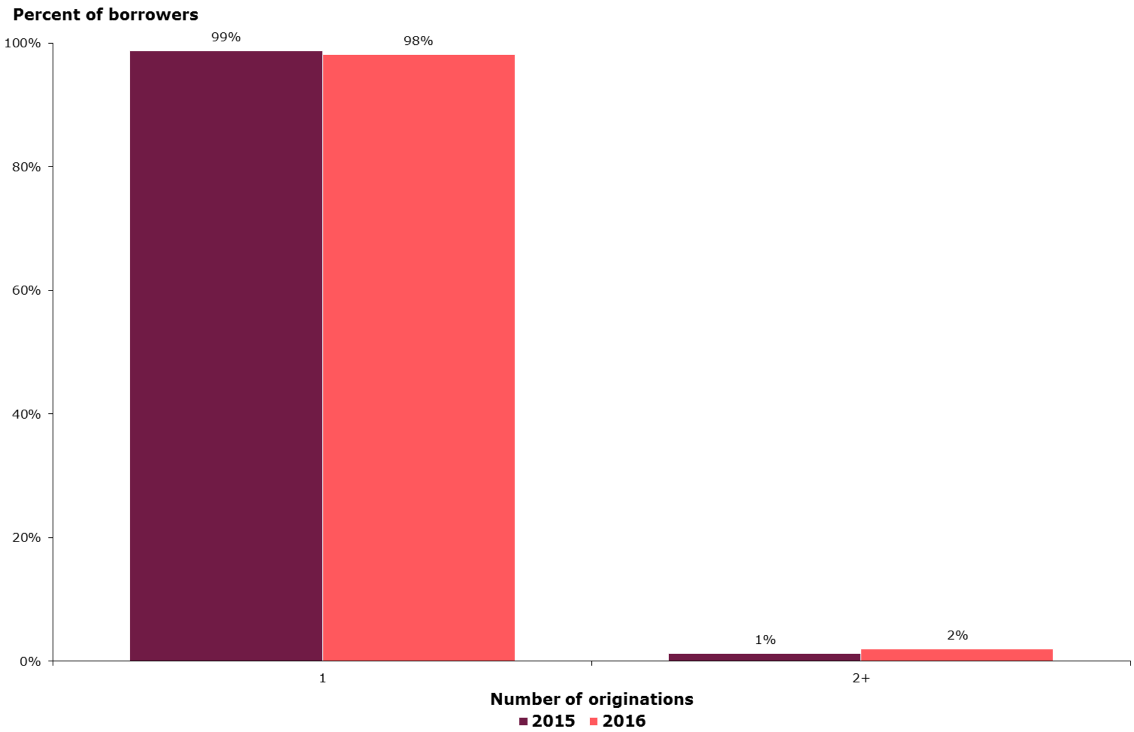
7.7 The proportion of the total stock of outstanding, non-defaulted store credit debt in arrears has been fairly stable between 2012 and 2016. By the end of 2016 this averaged less than 8% as displayed in Figure 60.

Figure 49: Outstanding stock of delinquent store credit agreements (January 2012 – December 2016)



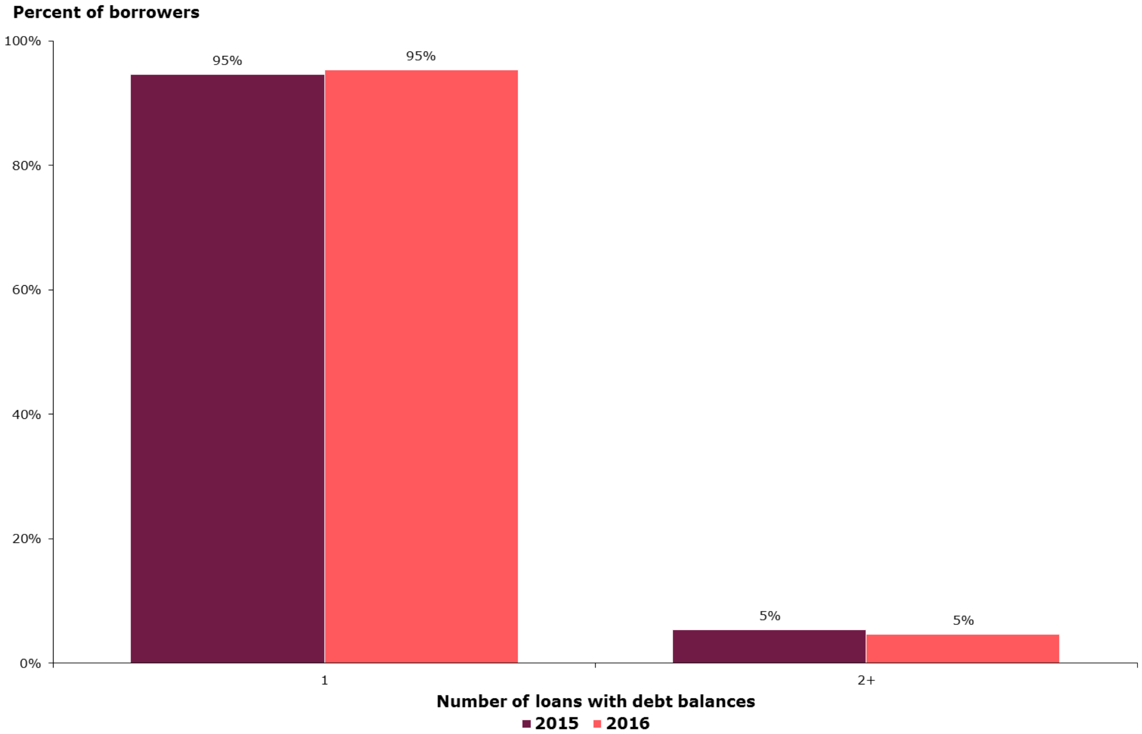
7.8 It is very rare for a consumer to either take out multiple store cards in a year or hold multiple store cards. Figure 50 shows that almost all consumers taking out a store card in 2016 took out just one card (and this barely changes for those taking out cards in 2015).

Figure 50: Distribution of store cards per borrower (2015, 2016)



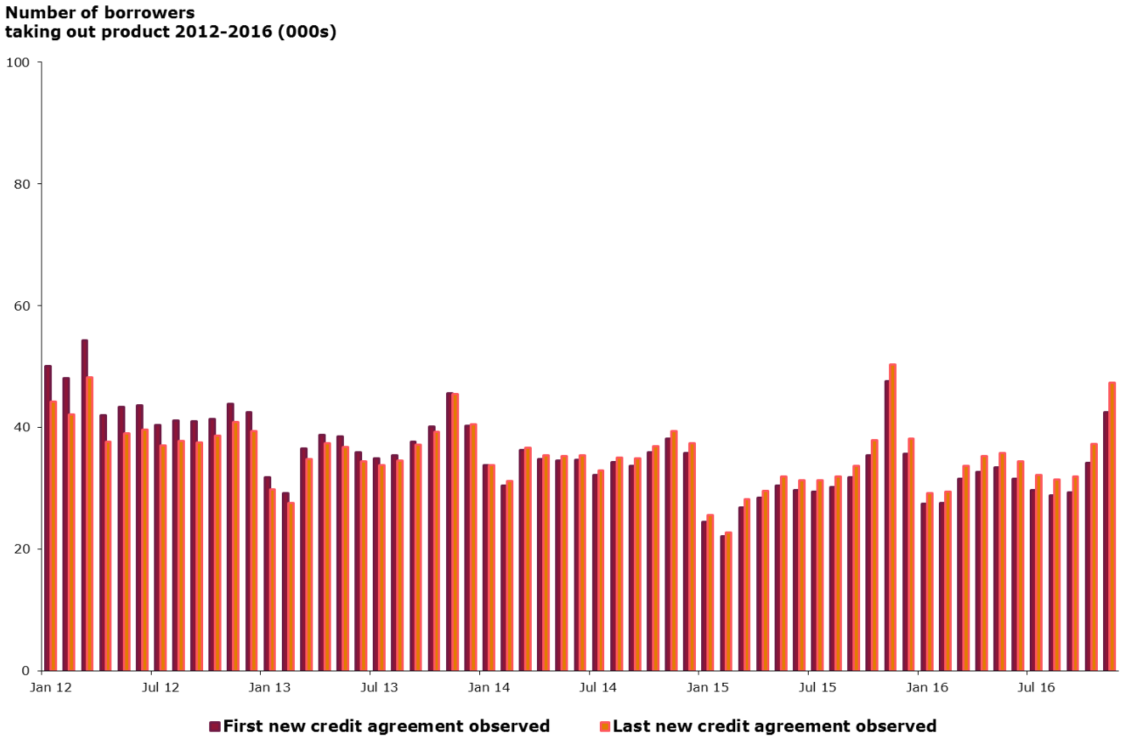
7.9 A similar picture is presented in Figure 51 for the number of store cards these users have outstanding debts on. 95% of these people have a single store card debt outstanding and 5% have two or more. There is little difference between 2015 and 2016 figures.

Figure 51: Distribution of number of store cards outstanding among borrowers with outstanding store card debt (2015, 2016)



7.10 Figure 52 shows the first and last date we observe consumers taking out a new store card between 2012 and 2016. We observe these closely align with one another reflecting consumers mostly taking out one store card.

Figure 52: Date store card borrowers are first and last observed taking out a new store card between January 2012 and November 2016



Consumer circumstances

7.11 Store card borrowers are typically in their mid to late thirties with a mean and median average age of 39 and 36 respectively. These borrowers also have lower than average incomes - estimated mean and median annual, net individual incomes are £21,800 and £17,500 respectively.[32]

7.12 When we examine the credit score profile of people taking out store cards we observe that they have noticeably higher scores than consumers using other less mainstream credit products. Former users of these products, who took out retail finance agreements in 2012, 2013 or 2014 but did not do so in 2015 or 2016, have even higher credit scores. These are displayed in Figure 53.

7.13 Examining the debts of 2016 borrowers displays that as of November 2014, almost half of people who would go on to take out a store card in 2016 had no outstanding personal debt. By November 2016, around 20% of these borrowers had no outstanding personal debt. The borrower with median amount of outstanding debt increased from £100 to £1,100 November 2014 to November 2016. When we order these same people by their outstanding debts we observe that the top 25% of borrowers had at least £2,200 in debt in November 2014 compared to at least £6,500 by November 2016.

7.14 The median ratio of outstanding personal debt to estimated annual, net individual incomes (DTI ratio) similarly increases from under 1% to 8% between January 2015 and January 2017. Figure 54 displays the distribution of the DTI ratio for these people compared to former borrowers who took out at least one store card agreement in 2012, 2013 or 2014 but not in 2015 or 2016. This displays how former borrowers are less indebted than those recently taking out new store cards.

[32] We do not observe income estimates for 4% of people.

Figure 53: January 2017 credit score of 2016 store card borrowers and former store card borrowers (borrowing store cards in 2012-2014 but not in 2015 or 2016), dotted line for mean

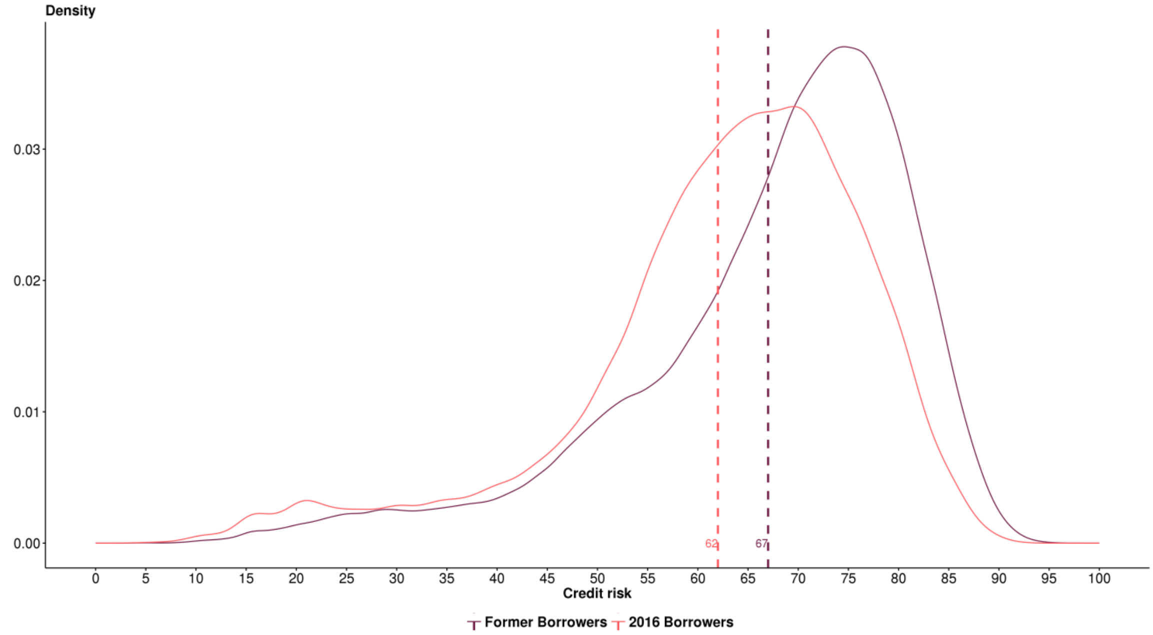
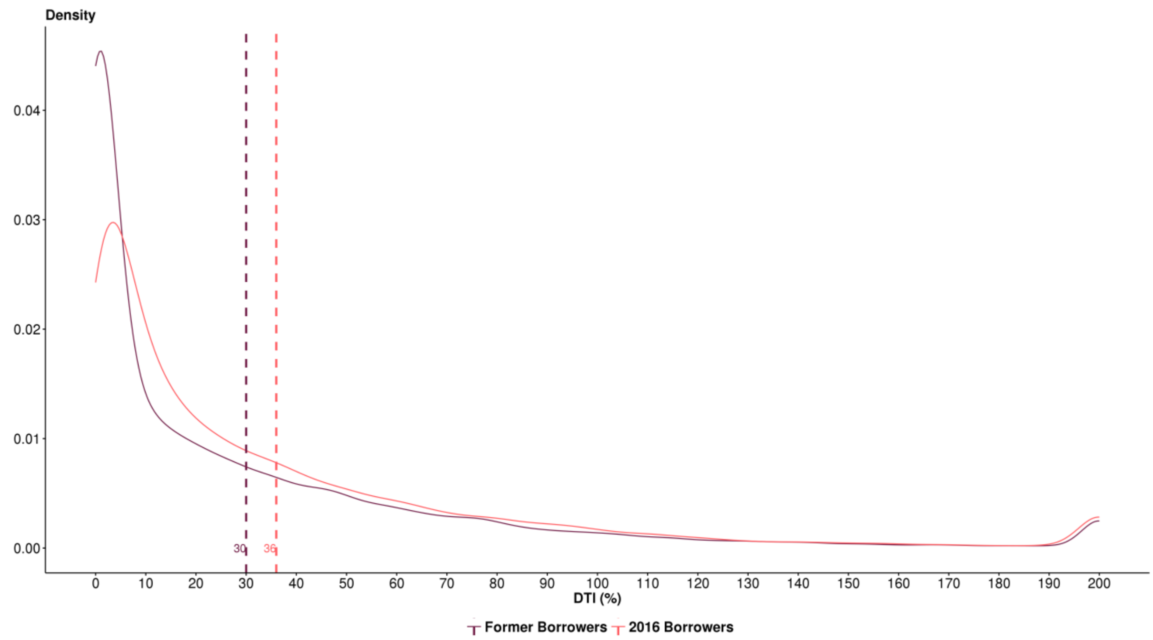


Figure 54: Distribution of January 2017 DTI ratio of 2016 store card borrowers and former store card borrowers (borrowing store card in 2012-2014 but not in 2015 or 2016) , dotted line for mean



7.15 Store card borrowers typically have relatively few credit items with outstanding personal debt. Among consumers taking out store cards during 2016 the median number of credit items (any form of personal debt) with outstanding debt on in November 2016 was two – up from one in November 2014. The top 10% of people had outstanding personal debt on six or more products – up from four two years' prior to this.

7.16 Table 13 examines consumers who took out at least one store card over a twelve month period (December 2015 to November 2016) and displays the proportion of these individuals who held outstanding debt on particular products as of November 2015 and November 2016. This shows that 3% of these people taking out new store cards already had outstanding store card debt in November 2015 and this increased to 47% by November 2016.

7.17 One in five people taking out store cards in 2016 had outstanding mortgage debt. 30% of store card borrowers had outstanding credit card debt in November 2014 and this increases to 38% by November 2016. Approximately a fifth of people hold overdraft, catalogue credit or unsecured personal loans. It is less common for these borrowers to have outstanding retail finance or motor finance debt. It is rare for these borrowers to hold debt on other products potentially considered to be high-cost such as HCSTC, home credit, rent-to-own or guarantor loans.

Table 13: Products held by borrowers taking out at least one store card between December 2015 and November 2016

	Percent of store card borrowers also holding debt on product as of…	
Product name	**November 2015**	**November 2016**
Store card	3%	47%
Credit card	30%	38%
Overdraft	18%	23%
Catalogue credit	17%	22%
Unsecured personal loan	16%	22%
Mortgage	20%	20%
Retail finance	13%	16%
Telecommunications	14%	16%
Motor finance	8%	11%
Other household bills	4%	4%
High-cost short-term credit (HCSTC)	2%	4%
Home credit	3%	3%
Other running account	<1%	1%
Rent-to-own	1%	1%
Guarantor loan	<1%	1%
Charge card	<1%	<1%
Logbook loan	<1%	<1%

7.18 Figure 55 shows that store card debt accounts for a small share - 3% - of outstanding debt of people taking out store cards in 2016. The overall debt balances of store credit borrowers is highly concentrated among three products. Unsecured personal loans account for over 30% of outstanding debts, credit cards and motor finance each account for near a quarter of debts. The remaining outstanding debt is primarily split across a variety of products – retail finance, overdraft and catalogue credit.

7.19 Finally, examining the other debts of store card borrowers took out between December 2015 and November 2016 shows that over one in five took out a new credit card and over one in seven a new unsecured personal loan. One in ten took out a new current account and just under this a new motor finance agreement. These are displayed in Figure 56.

Figure 55: Share of outstanding personal debt of store card borrowers (December 2015 – November 2016) as of November 2015 and November 2016

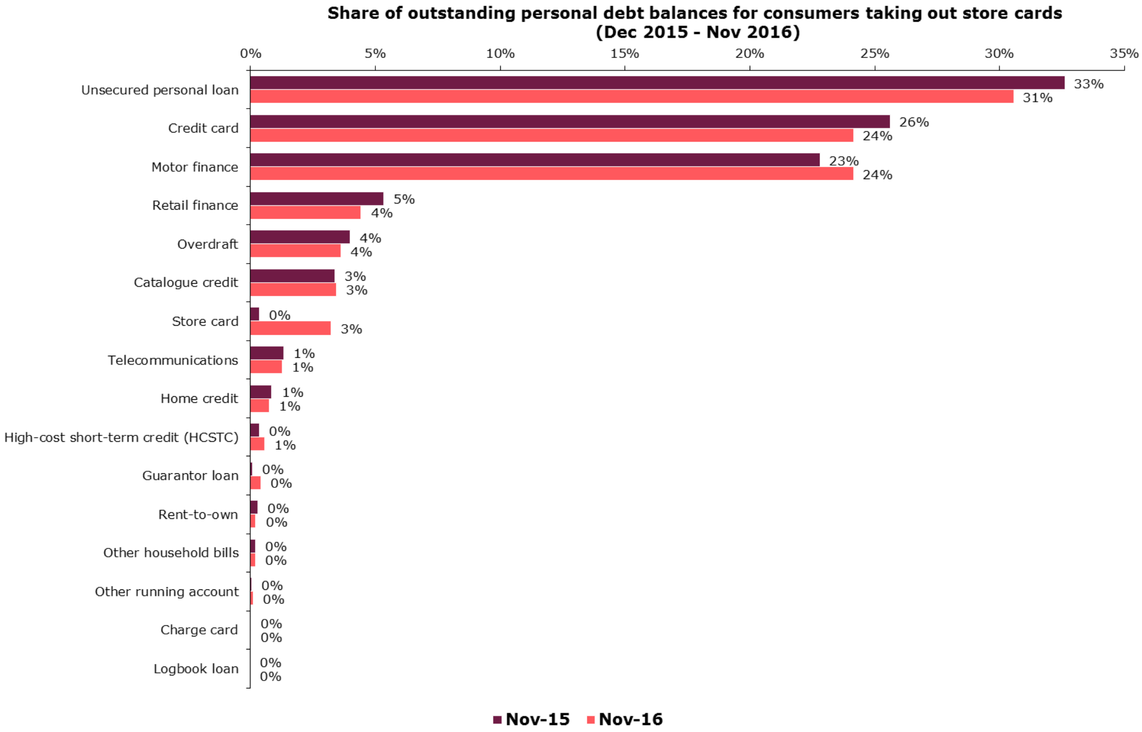
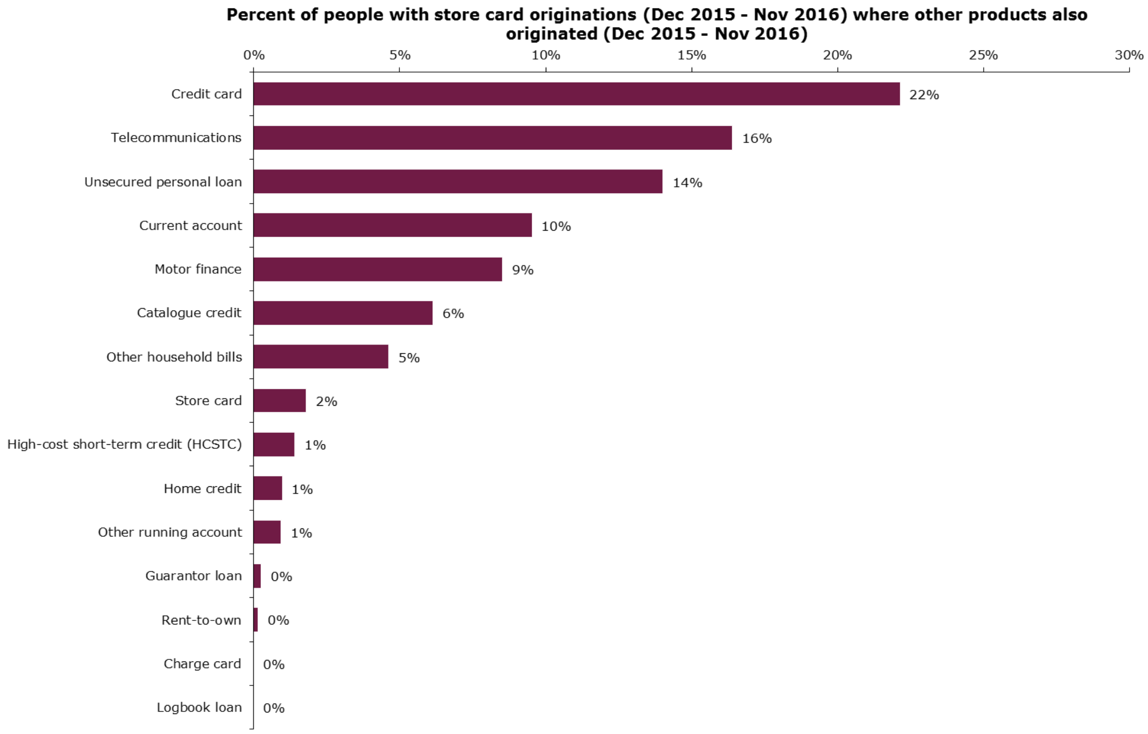


Figure 56: Products originated by store card borrowers (December 2015 – November 2016)

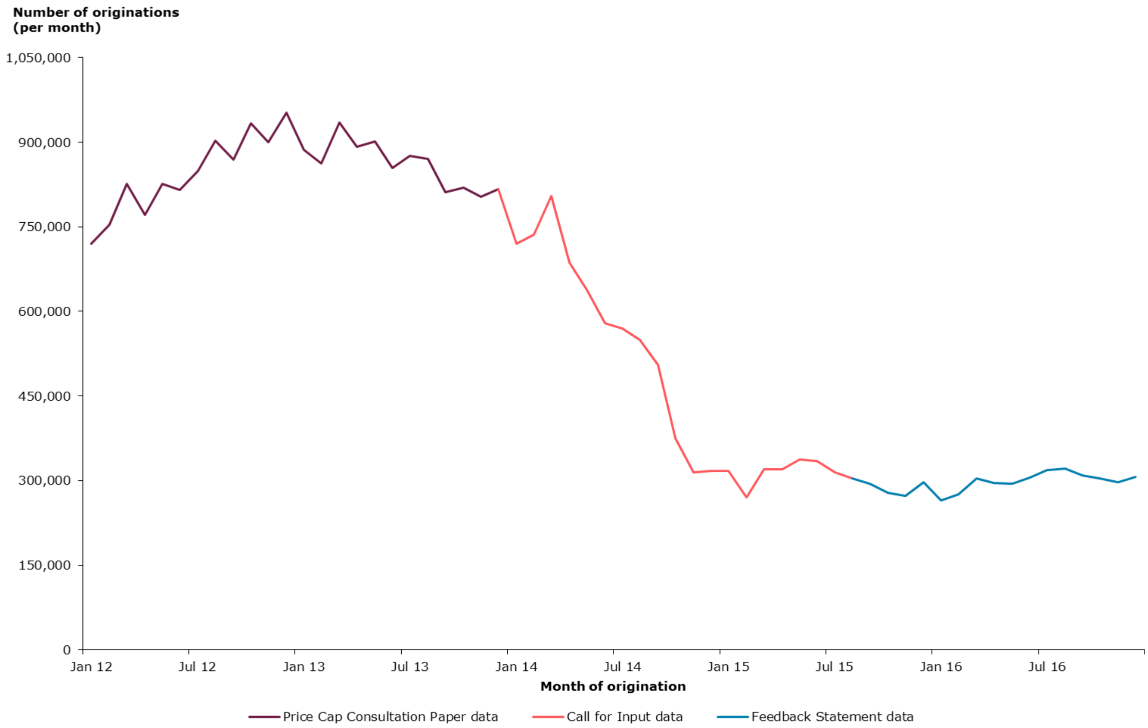


8 High-cost short-term credit (HCSTC)

Market size

8.1 High-cost short-term credit (HCSTC) loans are high-cost loans with APRs over 100% - these include payday loans.[33] The high-cost short-term credit (HCSTC) market has experienced significant changes over the last few years. By the end of 2016 the market was substantially smaller than it had been at its peak before it came under FCA regulation in April 2014. Figure 57 shows how the majority of the decline in lending occurred during the first half of 2014. Since the end of 2014 the number of new HCSTC loans taken out has stabilised at around 300,000 per month.

Figure 57: Number of HCSTC originations (January 2012 – December 2016)



8.2 1.6 million people had HCSTC debt on their credit file at the end of 2016 – up from 1.4 million at the end of 2015. Over the course of 2016, 760,000 people took out a HCTSC loan compared to 1.7 million in 2013. The number of borrowers grew slightly in 2016 compared to 2015 as shown in Table 14. The value of HCSTC loans originated during 2016 is similar to the total outstanding HCSTC debt at the end of 2016 - over £1bn. This represents growth since 2015, however, the market remains over 40% smaller than in 2013.

[33] Legal definition of HCSTC here:
https://www.handbook.fca.org.uk/handbook/glossary/G3328.html
As previously documented in high-cost credit review Call for Input
https://www.fca.org.uk/publication/call-for-input/call-input-high-cost-short-term-credit.pdf

Table 14: Size of HCSTC market (2013 – 2016)[34]

	Number of consumers taking out product (millions)	Average (mean) value of originations	Number of originations (millions)	Value of originations (billions)	Value of outstanding debt (billions)
2013	1.7	£240	10.3	£2.5	£2.5
2014	1.2	£240	5.3	£1.3	£1.3
2015	0.7	£260	3.3	£0.8	£0.8
2016	0.8	£290	3.6	£1.1	£1.1

8.3 Over the course of 2016 the value of originations picked up and, by the end of 2016, the value of monthly originations was 14% larger than a year earlier. This change was primarily the result of the increasing use of instalment loans with larger loan sizes and longer loan durations than traditional payday loans which are due to be repaid in a single instalment. By the end of 2016 the (mean) average HCSTC loan was just over £300 compared to being closer to £250 during much of 2012 to 2015.

Credit performance

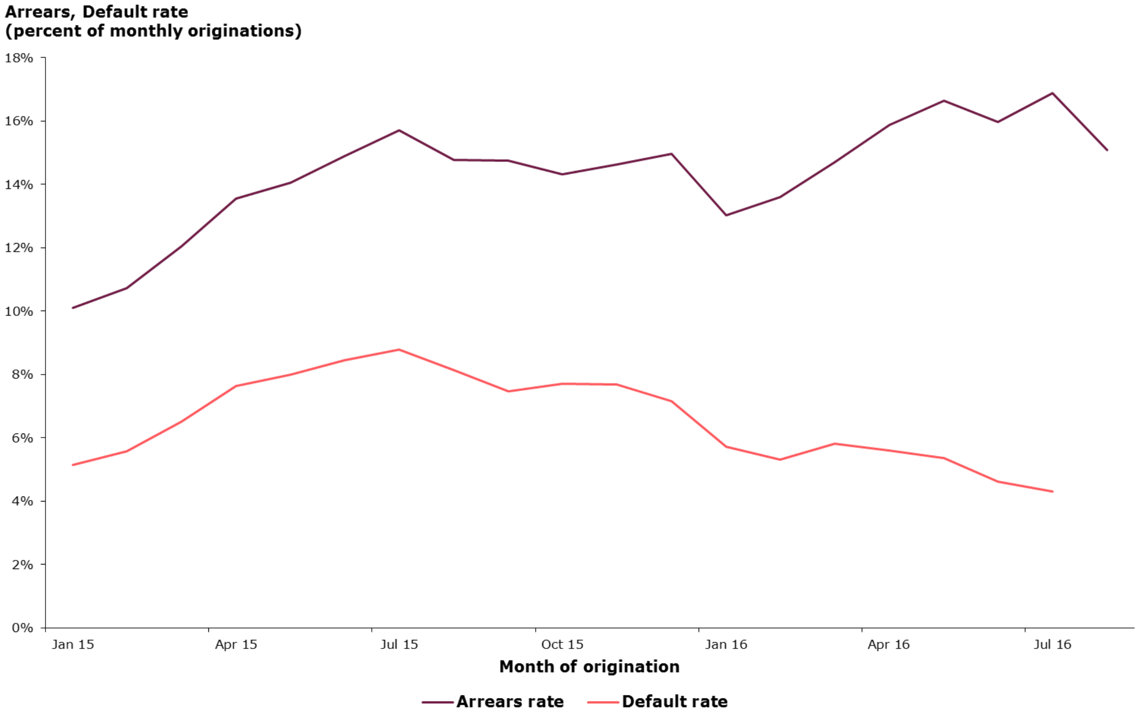
8.4 Examining a variety of measures of delinquencies displays somewhat different pictures of how the performance of HCSTC loans has changed between 2015 and 2016. We start by examining the most extreme form of delinquency – defaults. The 'default rate' is defined as the proportion of loans originated which enter default as recorded on a borrower's credit file. Figure 58 shows these to have significantly decreased with fewer than 6% of loans originated during the first half of 2016 entering default compared to over 8% of loans at times in 2015 (and double digits in 2014 as shown in prior data analysis).[35]

8.5 Taking a broader measure of delinquency – 'arrears rate' as measured by whether any arrears or default are recorded on that loan on a borrower's credit file – does not show such a decrease over time. When we examine HCTSC loans originated between January 2015 and August 2016 we find that the proportion of these loans which entered arrears or default was mainly 14% to 16% but fluctuated substantially - between 10% and 17%.

[34] 2012-13 figures from data collected for CP14/10 and PS14/16, 2014 figures from data collected for High-cost credit review call for input, 2015-16 figures from this data collection.

[35] As previously documented in high-cost credit review Call for Input
https://www.fca.org.uk/publication/call-for-input/call-input-high-cost-short-term-credit.pdf

Figure 58: Delinquency rates by HCTSC originations (January 2015 – August 2016)

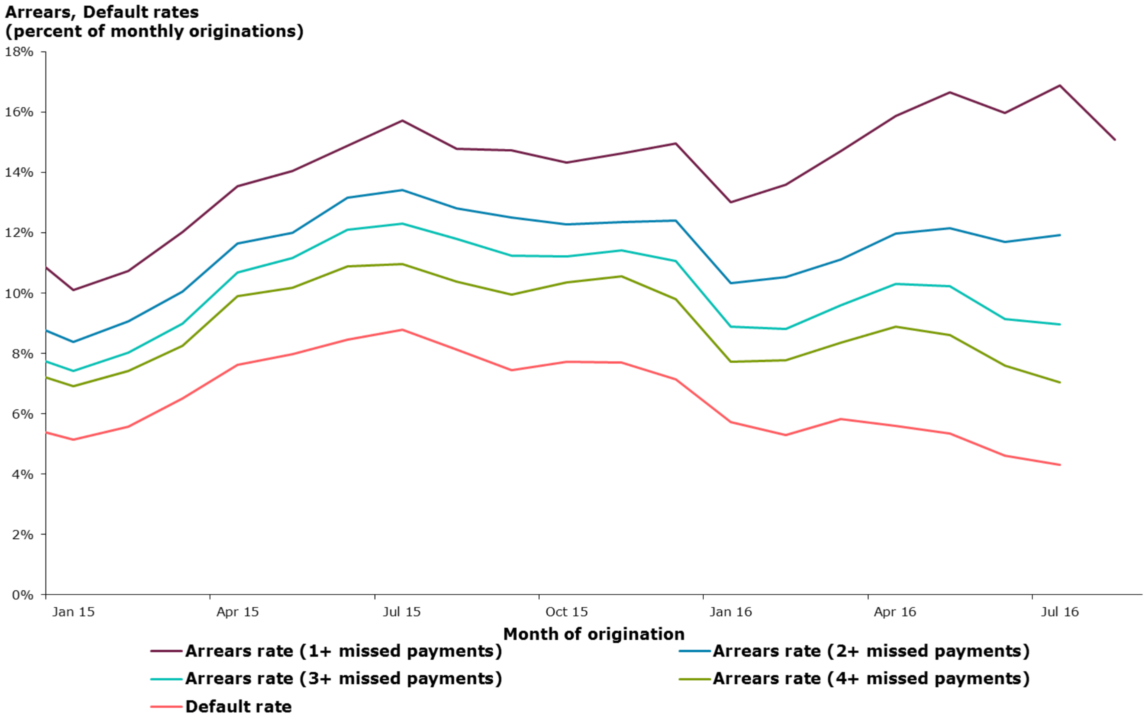


8.6 The differing pattern between arrears and default rates is unusual as normally these two series would be expected to be highly correlated (as they are historically and in other credit markets). When we explore the nature of such arrears it shows that this is primarily driven by consumers missing one payment but no more.

8.7 Other measures of more severe delinquency (missing at least two, three or four payments) follow more of a similar pattern to the default rate as shown in Figure 59. This indicates that arrears is typically temporary and likely a result of the shift in the market towards instalment loans where the chances of missing at least one payment are mechanically higher than traditional payday loans with a single repayment.[36] Another potential contributing factor is lenders may be showing greater forbearance to borrowers before recording loans as being in default.

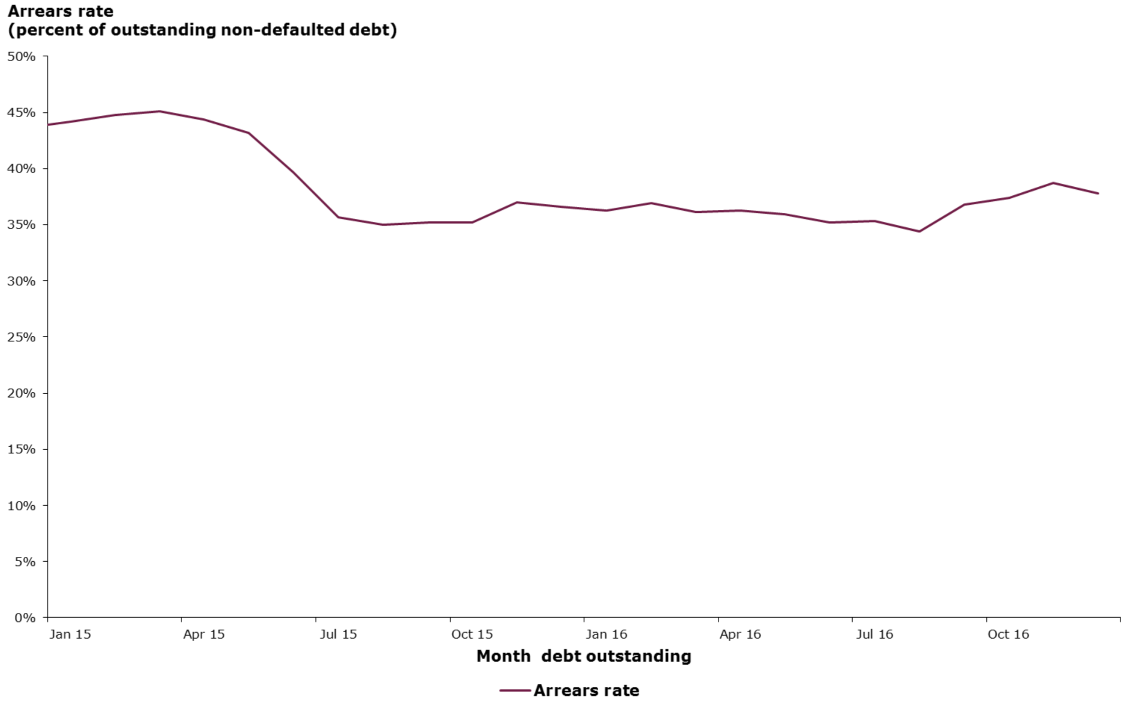
[36] I.e. if a consumer has seven repayments there are six more chances of them missing at least one repayment compared to payment on a traditional payday loan with one repayment due.

Figure 59: Stages of delinquency by HCSTC originations (January 2015 – August 2016)



8.8 Figure 60 displays that over a third of the outstanding stock of non-defaulted HCSTC debt is delinquent. This is partially mechanical based on the structure of HCSTC loans. The short-term nature of the HCSTC loans means that each loan which is repaid on-time – the overwhelming majority of loans – is only outstanding for a short period of time whereas loans which become delinquent stay outstanding for a comparatively much longer duration thus resulting in a 'high' stock of delinquent debt (relative to some other products). With this caveat in mind, over most of 2015 and 2016 the proportion of these debts being delinquent has remained near 35%.

Figure 60: Outstanding stock of delinquent HCSTC loans (January 2015 – December 2016)



8.9 Examining the repeated use of HCSTC shows that over a third of borrowers in 2016 only took out one HCSTC loan and the median number of loans taken out was two (see Figure 61). There were 10% of borrowers who took out 12 or more loans in 2016, however, due to the significant shrinkage in the market since 2014 this is a much smaller number of people than in 2013. Of borrowers with outstanding HCSTC debt, 46% have debt on one HCSTC loan and 87% on four or less loans as displayed in Figure 62.

Figure 61: Distribution of HCSTC loan originations per borrower (2015, 2016)

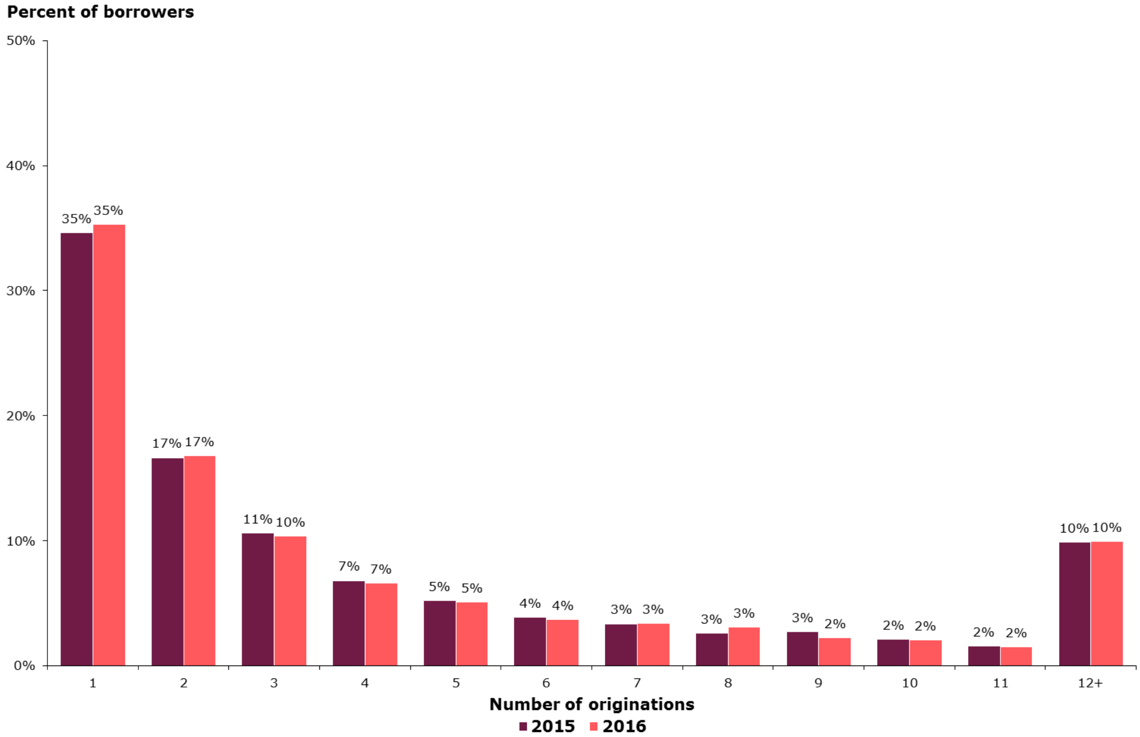
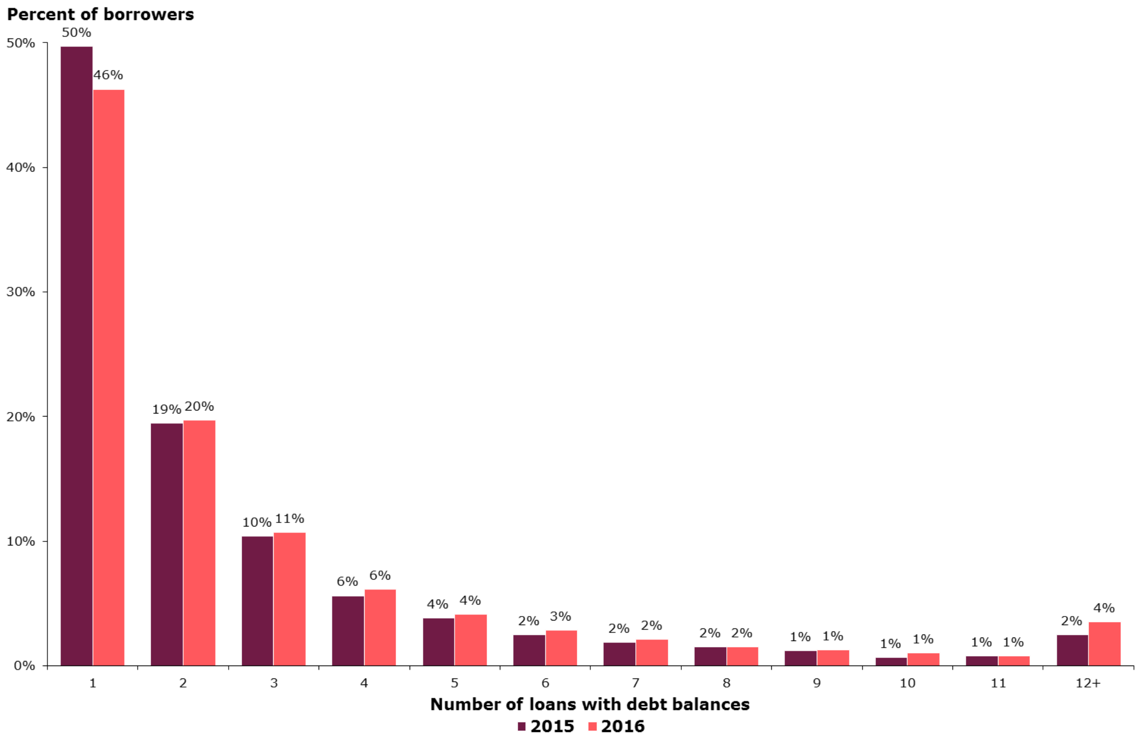


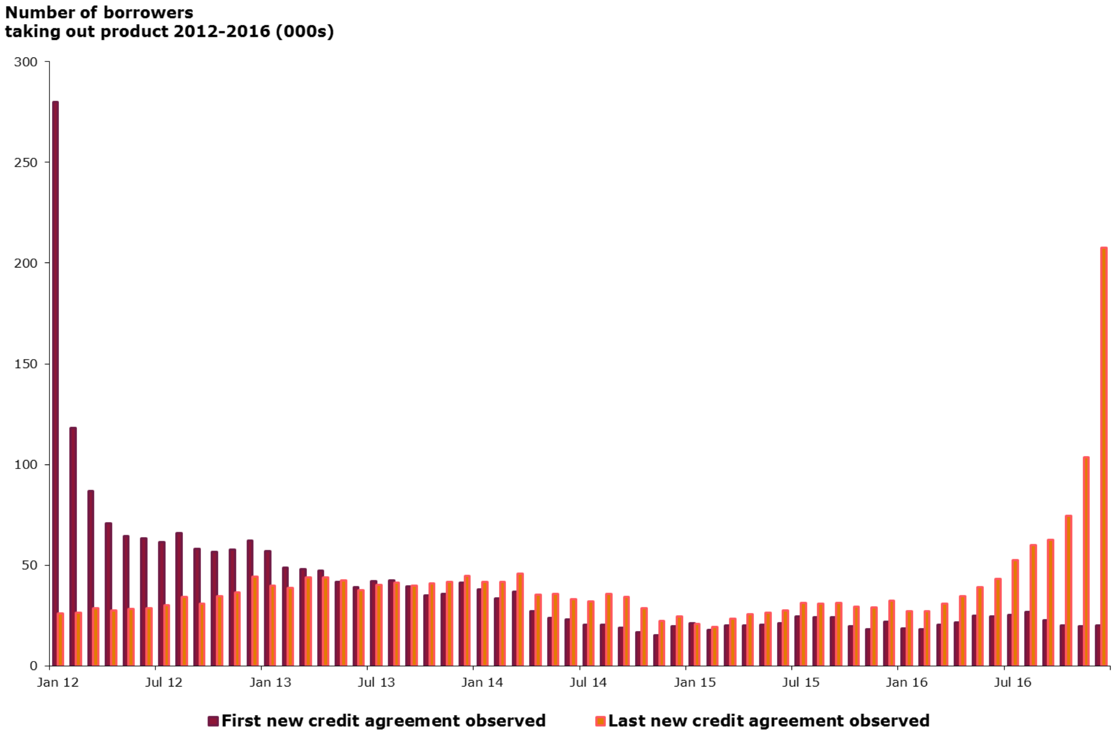
Figure 62: Distribution of number of HCSTC loans outstanding among borrowers with outstanding HCSTC debt (2015, 2016)



8.10 Of people who took out a HCSTC loan in 2015, over 30% no longer did so in 2016. This shows that there is quite a lot of churn in the customer base. Examining when we first observe a consumer to use HCSTC shows that the flow of new borrowers to the market has been fairly steady at around 20,000 per month since the end of 2014.

8.11 Figure 63 displays the first and last date we observe individuals taking out a new HCSTC loan between 2012 and 2016.[37] This shows that many customers first borrowed in 2012 (or potentially before our dataset started) and since 2015 the proportion of new borrowers has remained fairly flat. The last observed loan is fairly flat between 2012 and 2015 and then increases in 2016 reflecting how consumers take out multiple loans over time.

Figure 63: Date HCSTC borrowers are first and last observed taking out a new HCSTC loan between January 2012 and November 2016



Consumer circumstances

8.12 HCSTC borrowers in 2016 are typically young – with a mean and median average age of 35 and 32 respectively. These borrowers have estimated mean and median annual, net individual incomes of £23,600 and £20,000 respectively.[38]

8.13 Figure 64 compares the credit risk profiles, as of January 2017, of people who took out HCSTC loans in 2016 to those who used to take out HCSTC loans before 2015 but no longer do so (either by choice or because they are unable to access these products). This displays that former borrowers typically have better credit scores than current borrowers.

[37] Note that not all HCTSC loans appear in these data before the start of 2015 which means we do not expect to observe the first time all HCTSC borrowers took out a HCTSC loan.

[38] Income estimate not observed for 1% of borrowers

Figure 64: January 2017 credit score of 2016 HCSTC borrowers and former HCSTC borrowers (borrowing HCSTC in 2012-2014 but not in 2015 or 2016), dotted line for mean

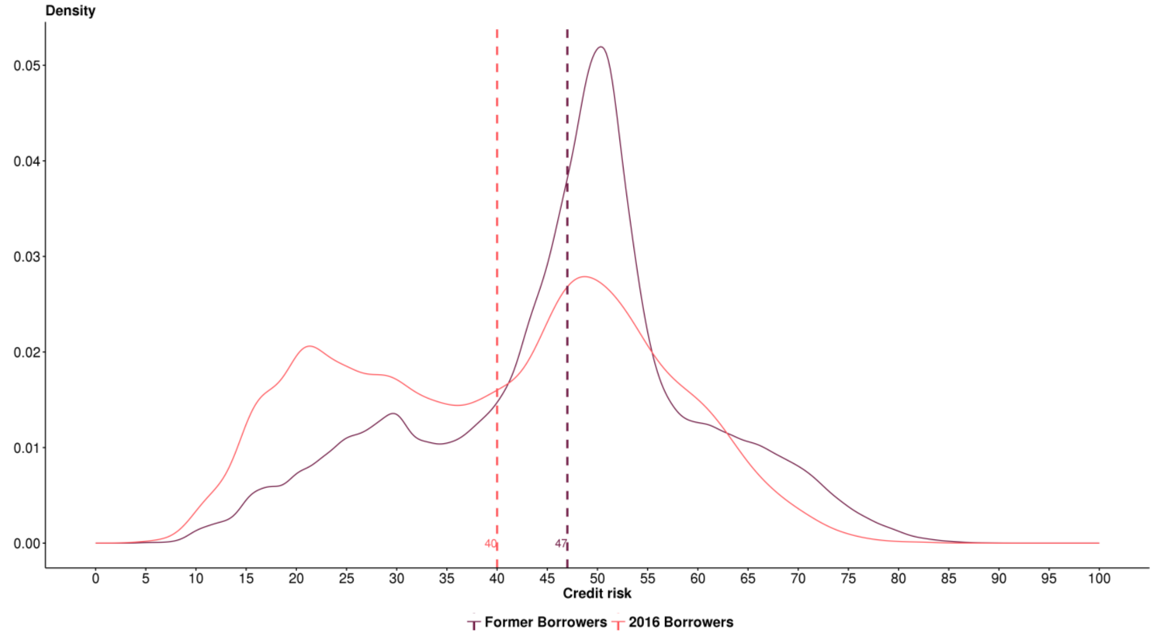
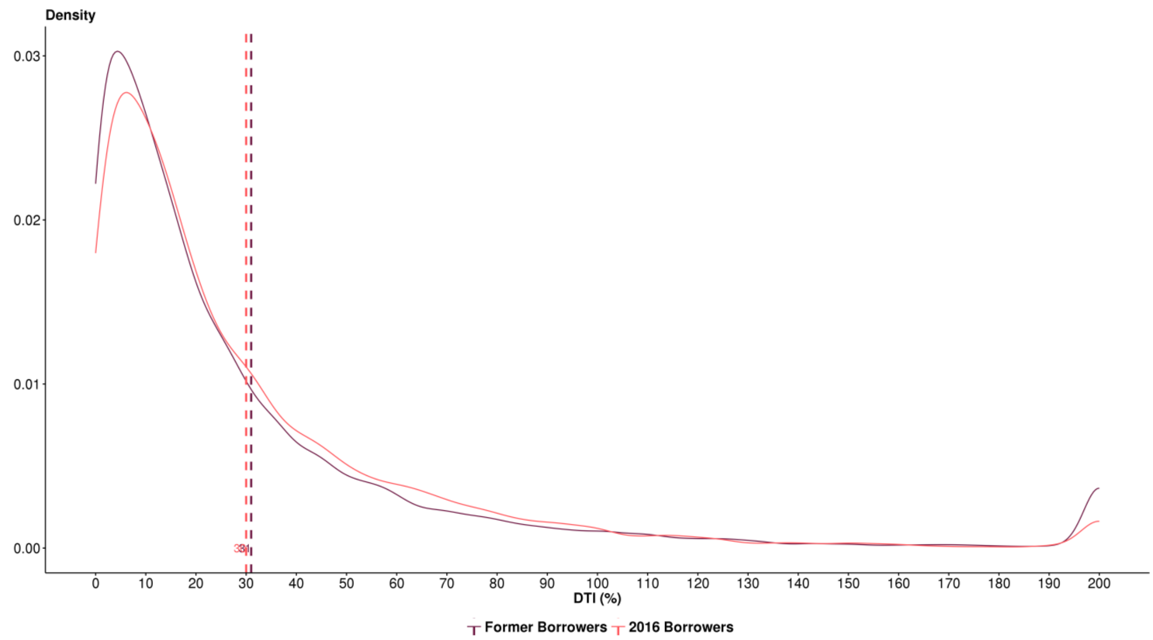


Figure 65: Distribution of January 2017 DTI ratio of 2016 HCSTC borrowers and former HCSTC borrowers (borrowing HCSTC in 2012-2014 but not in 2015 or 2016), dotted line for mean



8.14 There are a range of debt positions of borrowers using HCSTC – broadly reflecting a combination of being new-to-credit with little or no debt or highly indebted. As of November 2014, nearly a quarter of people who would go on to take out a HCSTC loan in 2016 had no outstanding personal debt. By November 2016, less than 5% of these borrowers had no outstanding personal debt. The median amount of outstanding debt among borrowers taking out HCTS loans increased from £1,100 to £3,600 from November 2014 to November 2016 respectively. And when we order these same people by their outstanding debts we observe that the top 25% of borrowers had at least £3,600 in outstanding debt in November 2014 which increased to at least £8,200 in November 2016.

8.15 The median ratio of outstanding personal debt to estimated annual, net individual incomes (DTI ratio) similarly increases from 6% to 18% between January 2015 and January 2017. Figure 65 shows how the distribution of DTI ratio is similar for 2016 borrowers to former borrowers who took out HCSTC loans in 2012, 2013 or 2014 but not in 2015 or 2016.

8.16 Among consumers taking out HCSTC loans during 2016 the median number of credit items (any form of personal debt) with outstanding debt on in November 2016 was five – up from two in November 2014. The top 10% of people had outstanding personal debt on twelve or more products – up from six two years' prior to this. Of credit items not in default, the median borrower had three credit items with outstanding personal debt in November 2014 and top 10% had nine or more.

8.17 We explore the composition of debts held by consumers taking out HCSTC loans in 2016 in greater detail to understand the interactions between products and how these change over time.

8.18 Table 15 shows the proportion of HCSTC borrowers (taking out a loan between December 2015 and November 2016) who hold debt on other products as of November 2015 and November 2016.

8.19 Of those taking out HCSTC debts, almost 40% already had outstanding HCSTC debt in November 2015 and over 70% still had outstanding debt by November 2016. Fewer than one in ten HCSTC borrowers have mortgage debt. Focusing on personal debt we observe that the proportion of borrowers with debts on most types of credit increases from November 2014 and November 2016.

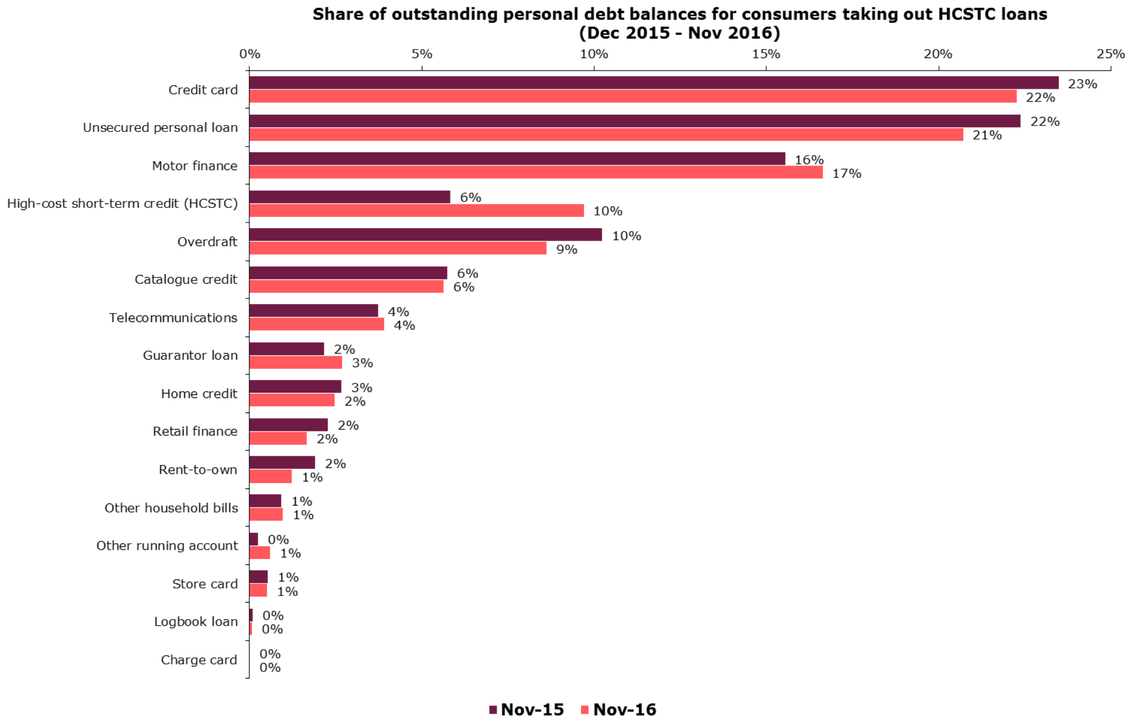
8.20 Particularly common types of personal debt held are credit card debt and overdraft debt – each of these is held by over 40% of people in November 2015 and 50% or more in November 2016. There are other especially noticeable increases in the proportion of individuals with outstanding telecommunications debt or catalogue credit debt.

8.21 Examining the composition of the value of outstanding personal debt of HCSTC borrowers by product types reveals further insights (Figure 66). Of the different products, credit cards and unsecured personal loans each account for over 20% of debts. This is then followed by motor finance accounting for over 15% and overdrafts near 10%. The shares of debt of these and other products change relatively little between November 2015 and November 2016 – the biggest shift being the increase in HCSTC debt from 6% of balances to 10%.

Table 15: Products held by borrowers taking out at least one HCSTC agreement between December 2015 and November 2016

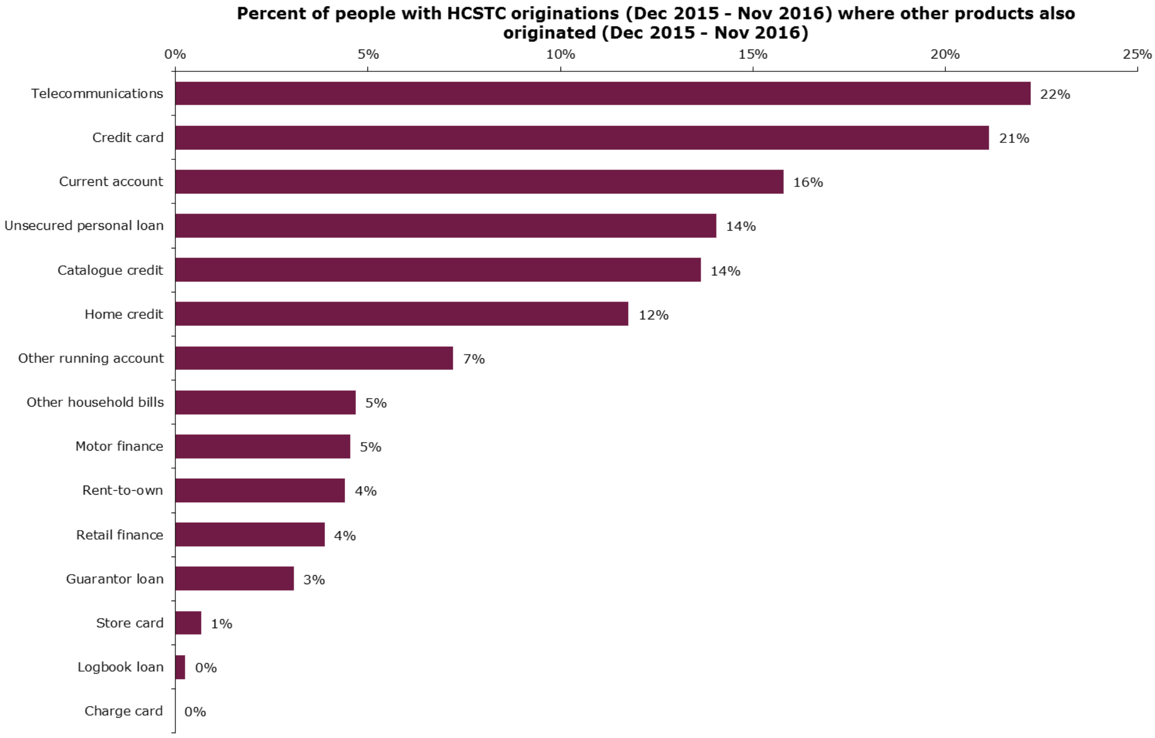
	Percent of HCSTC borrowers also holding debt on product as of…	
Product name	**November 2015**	**November 2016**
High-cost short-term credit (HCSTC)	39%	73%
Credit card	45%	57%
Overdraft	43%	50%
Telecommunications	35%	41%
Catalogue credit	25%	32%
Unsecured personal loan	22%	29%
Home credit	12%	15%
Motor finance	9%	12%
Other household bills	8%	10%
Other running account	3%	9%
Mortgage	9%	9%
Retail finance	8%	8%
Store card	6%	7%
Guarantor loan	3%	4%
Rent-to-own	4%	4%
Logbook loan	<1%	<1%
Charge card	<1%	<1%

Figure 66: Share of outstanding personal debt of HCSTC borrowers (December 2015 – November 2016) as of November 2015 and November 2016



8.22 The previous table and figure focused on the stock of debts held. Given that some products have long (or open-ended) borrowing durations and defaulted credit items can stay recorded as outstanding debt for six years we may expect this to trend up over time. We therefore complement this by focusing on the flow of newly originated debts of these same individuals who take out HCSTC loans. Figure 67 shows the proportion of these borrowers who take out a new credit product – and the type of product that is. This shows a significant minority of borrowers are able to take out other forms of credit during the 12 months after they take out a HCSTC loan. Approximately one in five take out a new credit card, one in six a new current account, one in seven a new personal loan or catalogue credit agreements and one in eight a new home credit loan.

__Figure 67: Products originated by HCSTC borrowers (December 2015 – November 2016)__

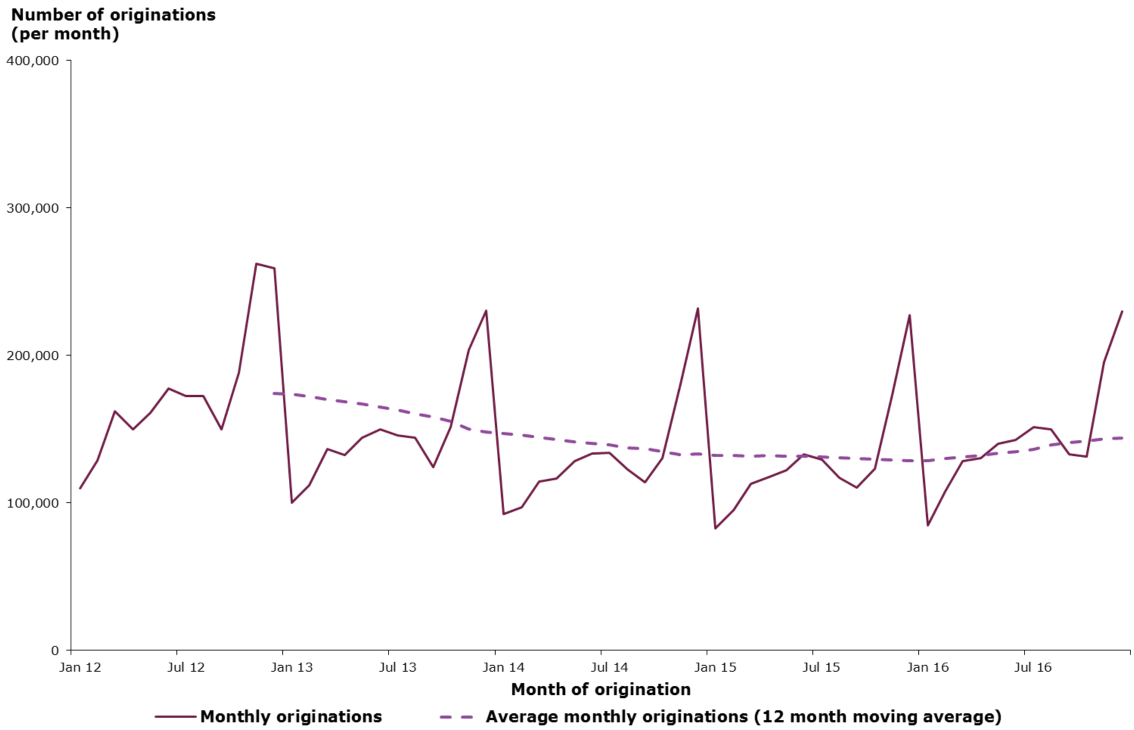


9 Home credit

Market size

9.1 The home-collected credit (home credit or doorstop lending) market is a very established market – having existed for over a hundred years. Home credit is a form of credit where payments are collected from a borrower's home.[39] During 2016, there were over 140,000 new loans taken out per month on average. This average masks large seasonal variations revealed in Figure 68 – typically a quarter of annual lending occurs during November and December.

Figure 68: Number of home credit originations (January 2012 – December 2016)



9.2 In 2016, almost 700,000 people took out a home credit loan compared to almost 900,000 in 2013. The number of borrowers grew slightly in 2016 compared to 2015 but is similar compared to 2014 levels as shown in Table 16. There were 1.6 million people with home credit debt on their credit file at the end of 2016. The £1.3bn value of total outstanding home credit debt at the end of 2016 is a notable increase on previous years. From 2015 to 2016 both the number and value of home credit originations also grew with average (mean) loan values increasing from £710 to £770.

9.3 There was particularly strong year-on-year growth by the end of 2016 relative to the end of 2015 - 12% and 21% growth in the number and value of lending respectively. However, taking a longer-term perspective, the market remains below the peak in our data in 2012 in terms of number of consumers and number of originations. This

[39] Legal definition of home credit loan agreements here: https://www.handbook.fca.org.uk/handbook/glossary/G3329.html

is also smaller than the estimated peak of the market (before our dataset) in the early 2000s based on an earlier Competition Commission investigation.[40]

Table 16: Size of home credit market (2012 – 2016)

	Number of consumers taking out product (millions)	**Average (mean) value of originations**	**Number of originations (millions)**	**Value of originations (billions)**	**Value of outstanding debt (billions)**
2012	0.9	£680	2.1	£1.4	£1.0
2013	0.8	£700	1.8	£1.2	£1.0
2014	0.7	£670	1.6	£1.1	£0.9
2015	0.6	£710	1.5	£1.1	£0.9
2016	0.7	£770	1.7	£1.3	£1.1

Credit performance

9.4 Different measures of delinquency show a consistent pattern of fewer new home credit loans becoming delinquent. From 2012 to 2015 there have been significant declines in the proportion of new home credit originations entering arrears as displayed in Figure 69. In 2012 the arrears rate had been over 40% - even peaking at 50% for some monthly vintages - whereas by 2015 and 2016 this had declined to typically be nearer to 30%. Unlike many other credit products, home credit agreements have weekly rather than monthly payments due. In CRA data an arrear on a home credit agreement is therefore reported if a consumer has missed the equivalent to the value of one month's payment (4.33 weeks).[41]

9.5 Figure 70 shows that the proportion of new loans entering default had often been around 14% for those issued in 2012 and 2013. Newer vintages of loans, 2015 and the first half of 2016, have lower default rates - below 5% percent – though we expect these to increase over time as these vintages mature.

9.6 Figure 71 examines other measures of delinquency (missing at least two, three or four payments) for the 2015 vintage of home credit loans. There are quite large differences between the proportion of loans which miss one or more, two or more, three or more months of payments or end up in default. A relatively small subset of loans which enter arrears eventually end up in default. For example, for the 2015 cohort, fewer than 15% of loans which missed two or more months of payments have ended up in default.

[40] http://webarchive.nationalarchives.gov.uk/20140402141250/http://www.competition-commission.org.uk/assets/competitioncommission/docs/pdf/non-inquiry/rep_pub/reports/2006/fulltext/517_section2.pdf

[41] http://www.scoronline.co.uk/sites/default/files/High%20Level%20Prinicples%20Document%20Version%202%20final.pdf

Figure 69: Arrears rates by vintage of home credit origination (January 2012 – June 2016)

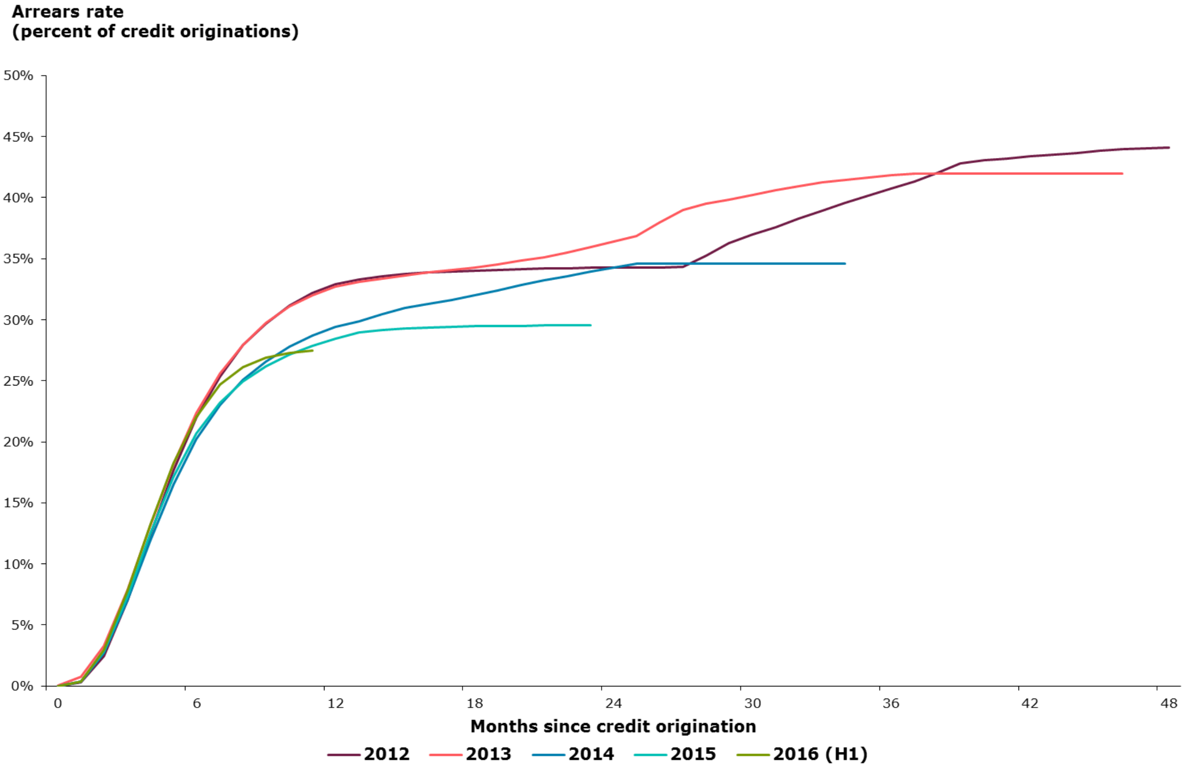


Figure 70: Default rates by vintage of home credit origination (January 2012 – June 2016)

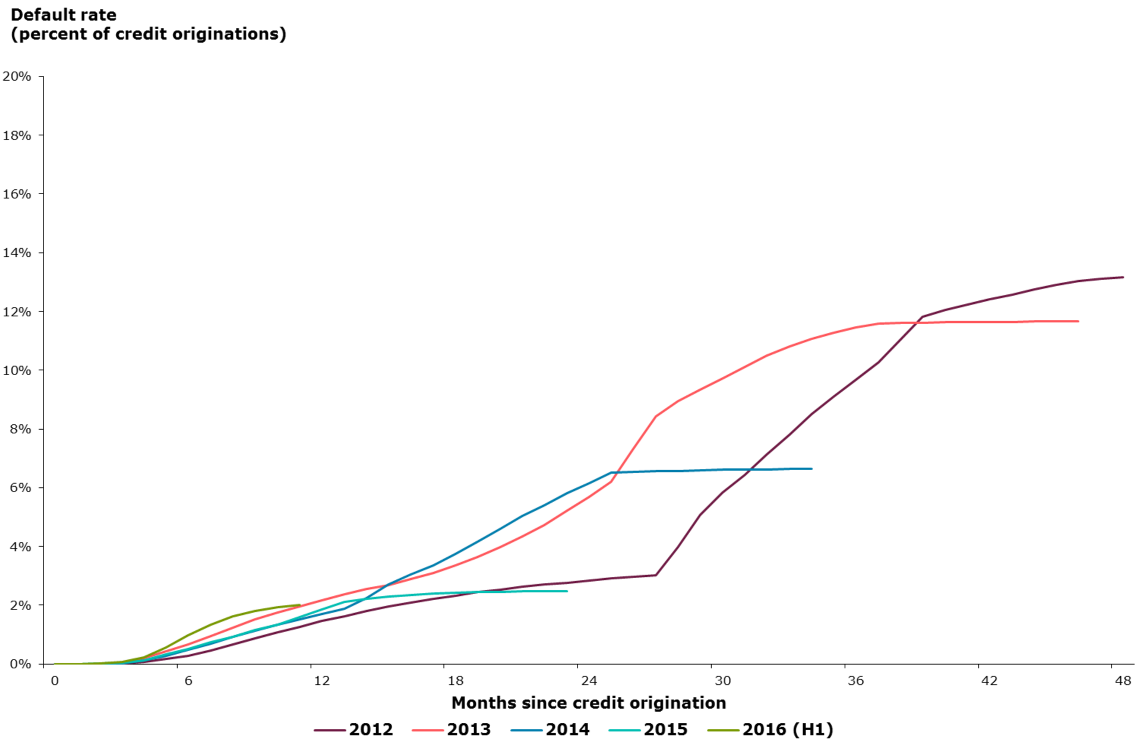
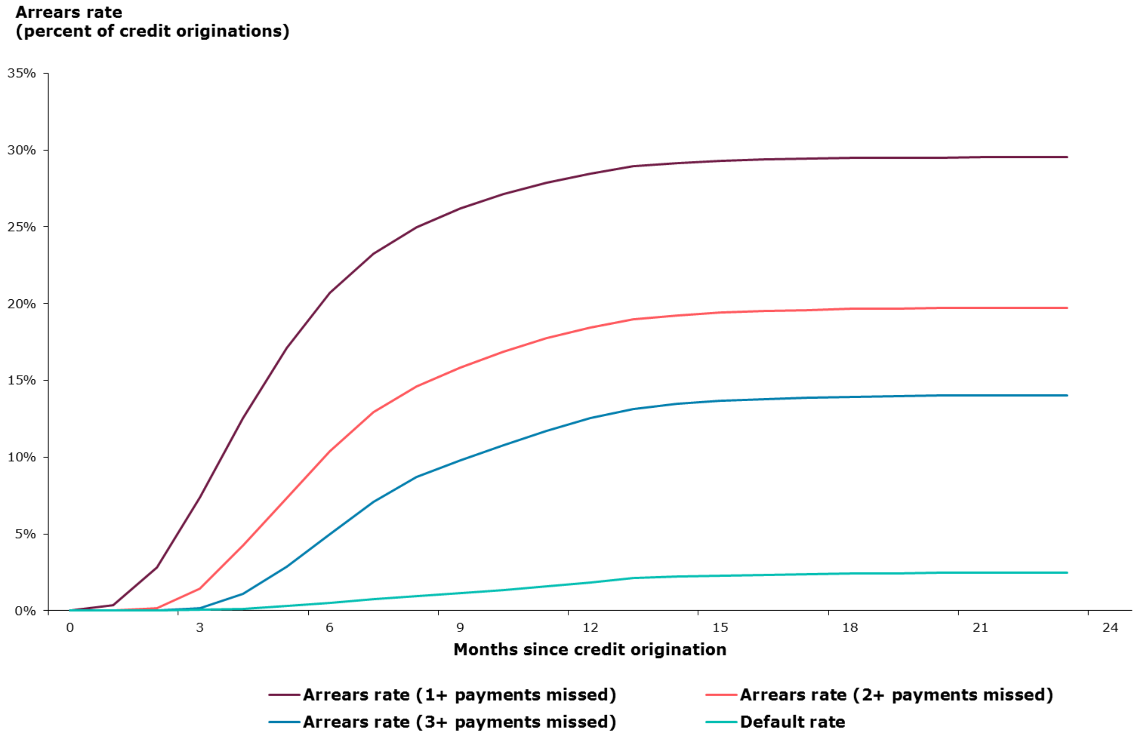
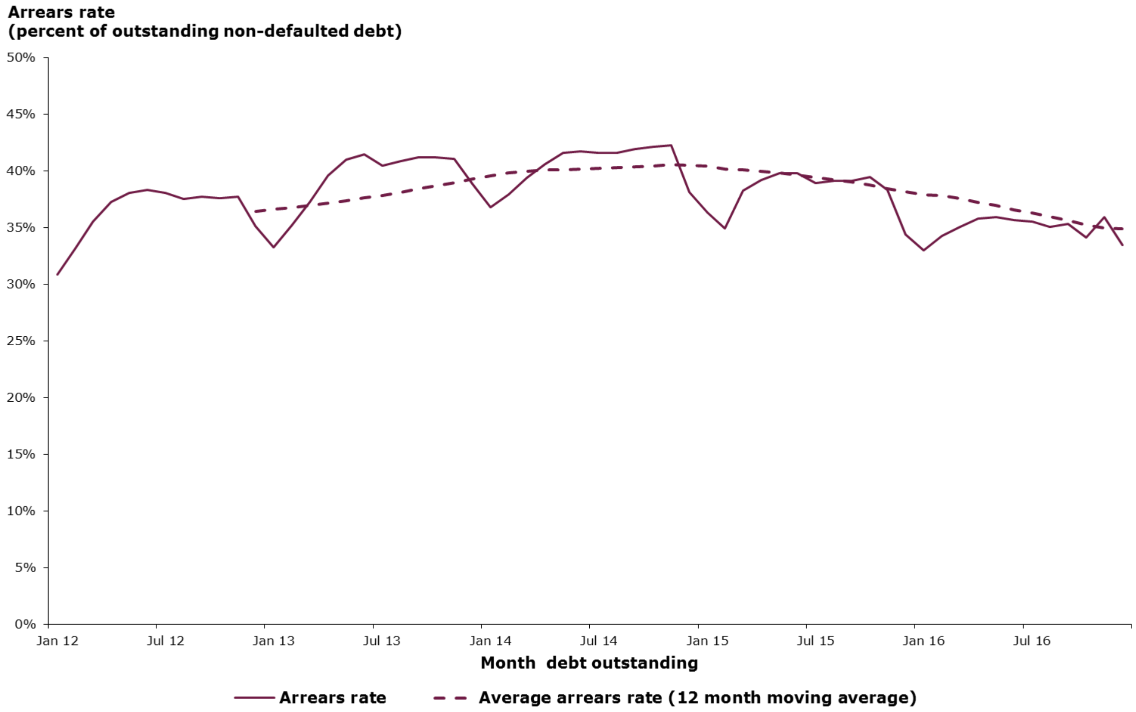


Figure 71: Stages of delinquency for 2015 home credit origination vintage



9.7 As displayed in Figure 72, the proportion of the total stock of outstanding, non-defaulted home credit debt in arrears was slightly increasing between 2013 and 2014 but has since decreased. But by the end of 2016 it remains around 35% - this is partly driven by the relatively short-term nature of home credit loans which mean that delinquent loans stay reported on a credit file longer than non-delinquent loans.

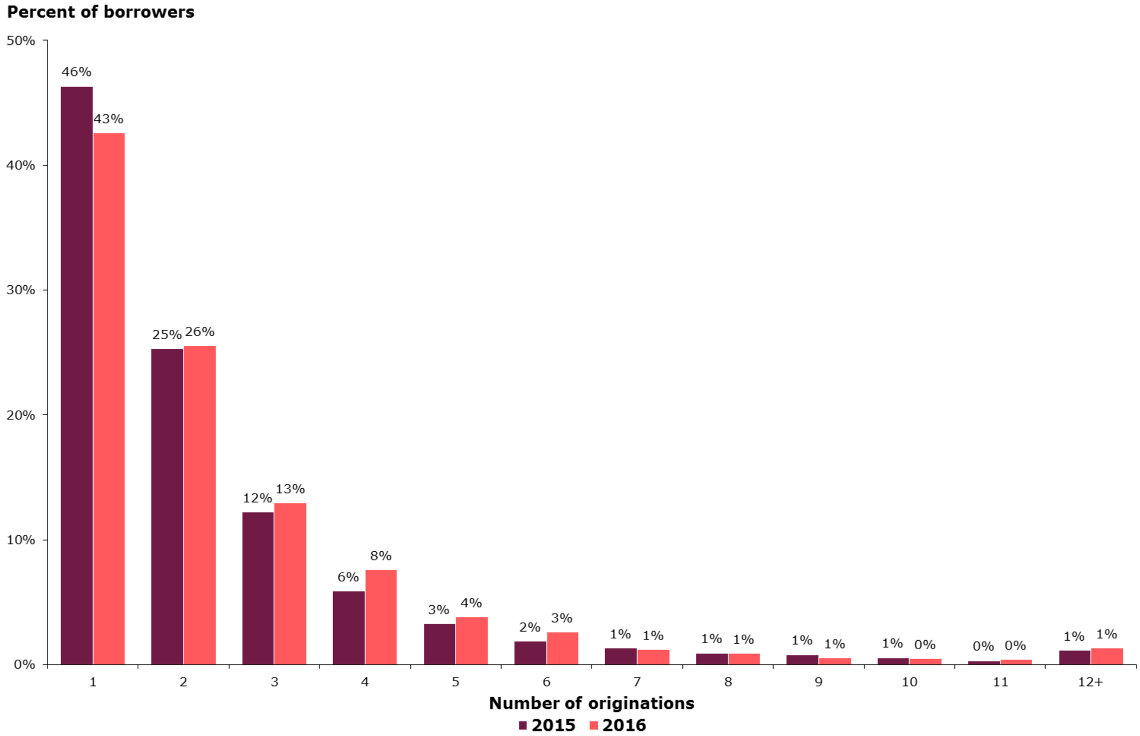
Figure 72: Outstanding stock of delinquent home credit loans (January 2012 – December 2016)



9.8 Examining the repeated use of home credit borrowing shows that over 40% of people using this product in 2016 took out one loan that year while the median took out two loans. Around one quarter of home credit users took out two loans, over 10% three loans and 1% took out 12 or more loans – these figures have not substantively changed between 2015 and 2016 (see Figure 73).

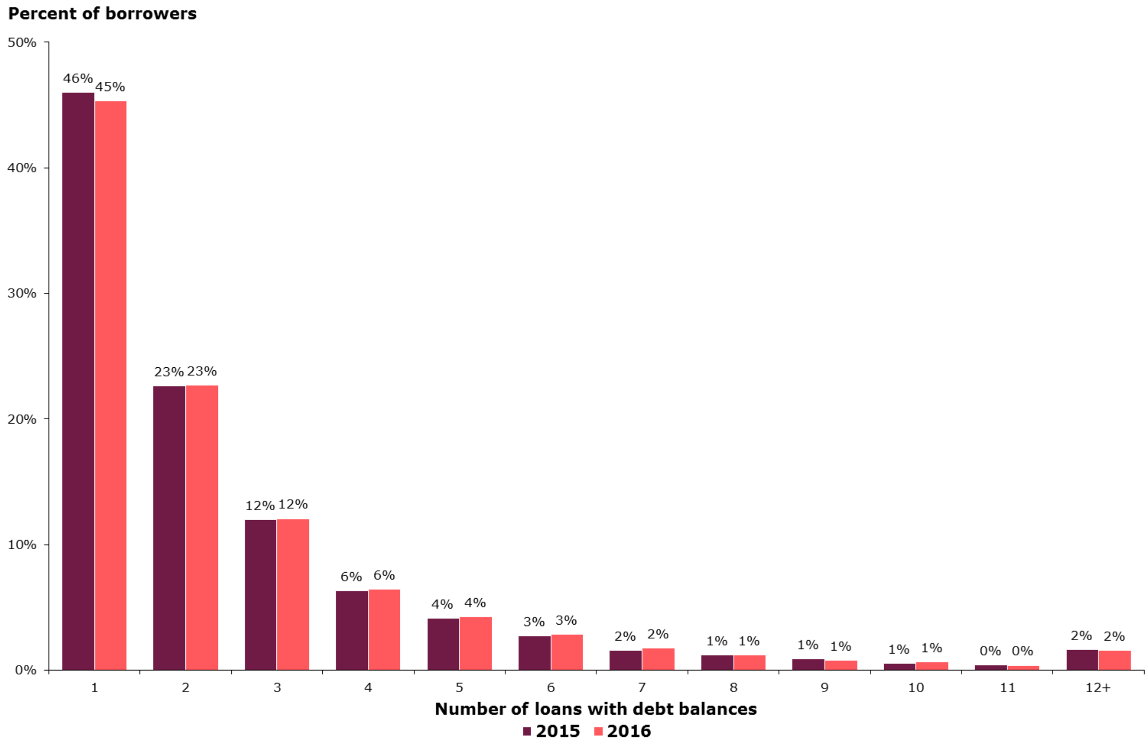
9.9 Comparing these to the number of home credit products home credit users have outstanding debts on - in Figure 74 - shows a similar pattern – with having one, two or three home credit loans outstanding being common. CRA data do not indicate when a loan has been refinanced, however, we can infer this based on whether the outstanding debts on a credit product have increased (without the product entering arrears or default) – this did not show much evidence of refinancing, however, it may be due to how these loans are reported.[42]

Figure 73: Distribution of home credit loan originations per borrower (2015, 2016)



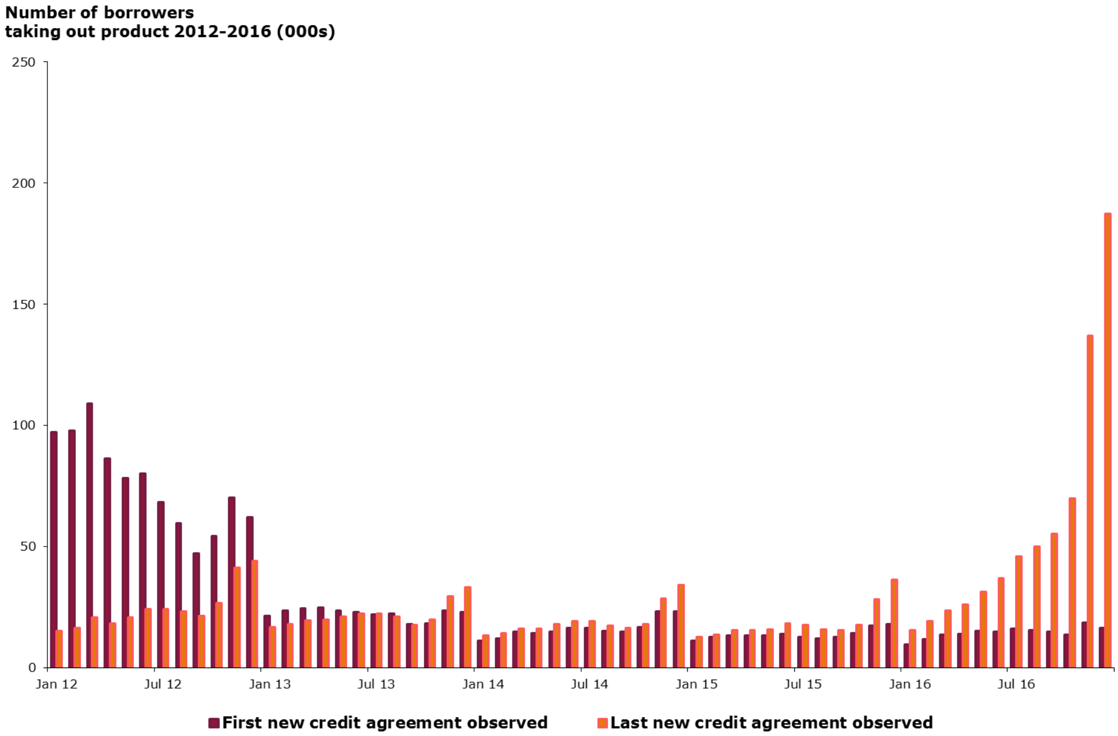
[42] Using a variety of thresholds for how large the change in balance needed to be in order to be recorded as a refinancing did not change this conclusion.

Figure 74: Distribution of number of home credit loans outstanding among borrowers with outstanding home credit debt (2015, 2016)



9.10 We observe fewer new home credit customers each month than in the HCSTC market. Combining this with the relative lack of change in the overall number of borrowers over time shows the customer base of this market to be fairly established. This is shown by Figure 75 where we report the timing of the first and last home credit agreement a consumer took out between 2012 and 2016. Here we can see many borrowers first took out a home credit loan in 2012 (or before the start of our dataset). There is little change between 2013 and 2015 – the number of borrowers entering the market matching the proportion exiting the market. We observe a relatively high number of consumers who borrowed at any time 2012 to 2016 still borrowing at the end of 2016. This indicates it is fairly common for people to be repeatedly borrowing on home credit over fairly long periods of time.

Figure 75: Date home credit borrowers are first and last observed taking out a new home credit agreement between January 2012 and November 2016



Consumer circumstances

9.11 Home credit borrowers are typically older than other users of products potentially considered as high-cost. These have a mean and median average age of 44 and 42 respectively. These borrowers also have relatively low incomes - estimated mean and median annual, net individual incomes just £17,500 and £15,500 respectively. No income estimate is observed for 15% of home credit borrowers.

9.12 Figure 76 compares the credit score profiles, as of January 2017, of people who took out home credit loans in 2016 to those who used to take out home credit loans before 2015 but no longer do so (either by choice or because they are unable to access these products). This displays former users have higher scores on average than 2016 borrowers. Home credit borrowers typically have low credit scores but are not as low as HCSTC borrowers.

9.13 Relative to these people's incomes, their personal debt levels are relatively high. As of November 2014, over 15% of people who would go on to take out a home credit loan in 2016 had no outstanding personal debt. By November 2016, less than 5% of these borrowers had no outstanding personal debt. The borrower with median amount of outstanding debt more than doubled from £1,200 to £2,800 November 2014 to November 2016. And when we order these same people by their outstanding debts we observe that the top 25% of borrowers had at least £3,100 in debt in November 2014 compared to at least £5,700 by November 2016.

9.14 The median ratio of outstanding personal debt to estimated annual, net individual incomes (DTI ratio) similarly increases from 10% to 22% January 2015 to January 2017. Figure 77 compares the DTI ratio of 2016 home credit borrowers to former borrowers (taking out products in 2012, 2013 or 2014). This shows how former borrowers have noticeably lower DTI ratios on average compared to 2016 borrowers.

Figure 76: January 2017 credit score of 2016 home credit borrowers and former home credit borrowers (borrowing home credit in 2012-2014 but not in 2015 or 2016), dotted line for mean

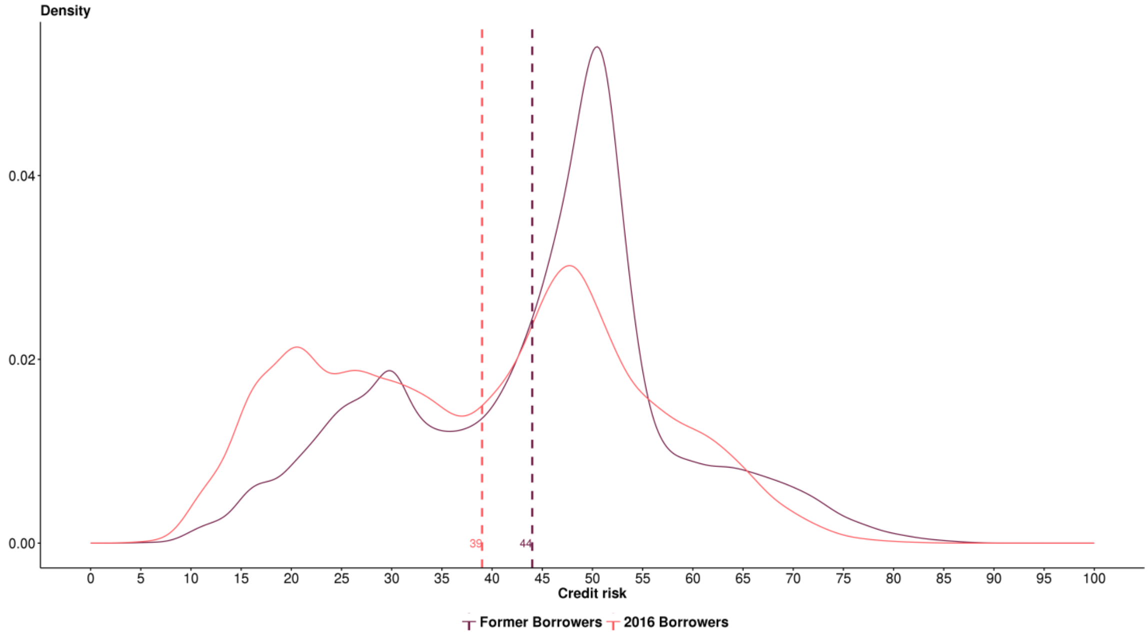
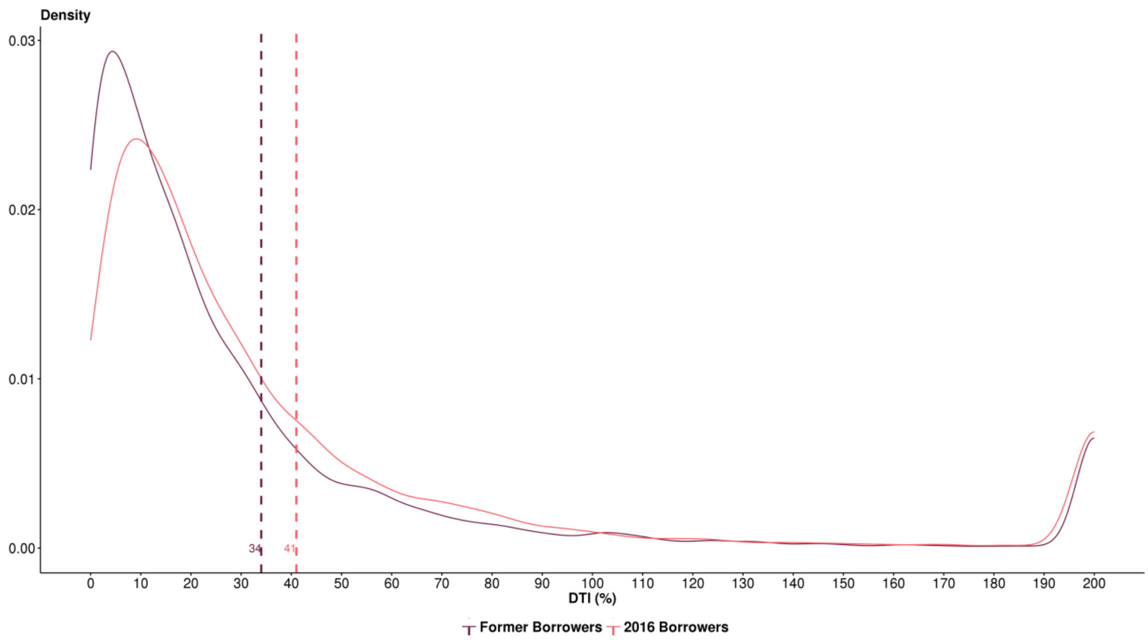


Figure 77: Distribution of January 2017 DTI ratio of 2016 home credit borrowers and former home credit borrowers (borrowing home credit in 2012-2014 but not in 2015 or 2016), dotted line for mean



9.15 Among consumers taking out home credit loans during 2016 the median number of credit items (any form of personal debt) with outstanding debt in November 2016 was five – up from three in November 2014. The top 10% of people had outstanding personal debt on twelve or more products – up from eight two years' prior to this. Of credit items not in default, the median borrower had three credit items with outstanding personal debt in November 2014 and top 10% had eight or more.

9.16 We explore the composition of debts held by consumers taking out home credit loans in 2016 in greater detail to understand the interactions between products and how these change over time. Table 17 shows the proportion of home credit borrowers (taking out a loan between December 2015 and November 2016) who hold debt on other products as of November 2015 and November 2016. Of those taking out home credit debts, 70% already had outstanding home credit debt in November 2015 and over 90% still had outstanding debt by November 2016.

9.17 Just one in twenty home credit borrowers have mortgage debt. Focusing on personal debt we observe that the proportion of borrowers with debts on quite a few types of credit increases from November 2014 and November 2016. A third of borrowers had catalogue credit debt in November 2015 and this increases to 40% in November 2016. Credit card debt and overdraft debt are also common - each of these is held by 29% of people in November 2015 and over 30% in November 2016. There are other especially noticeable increases in the proportion of individuals with outstanding telecommunications debt or other household bill debt.

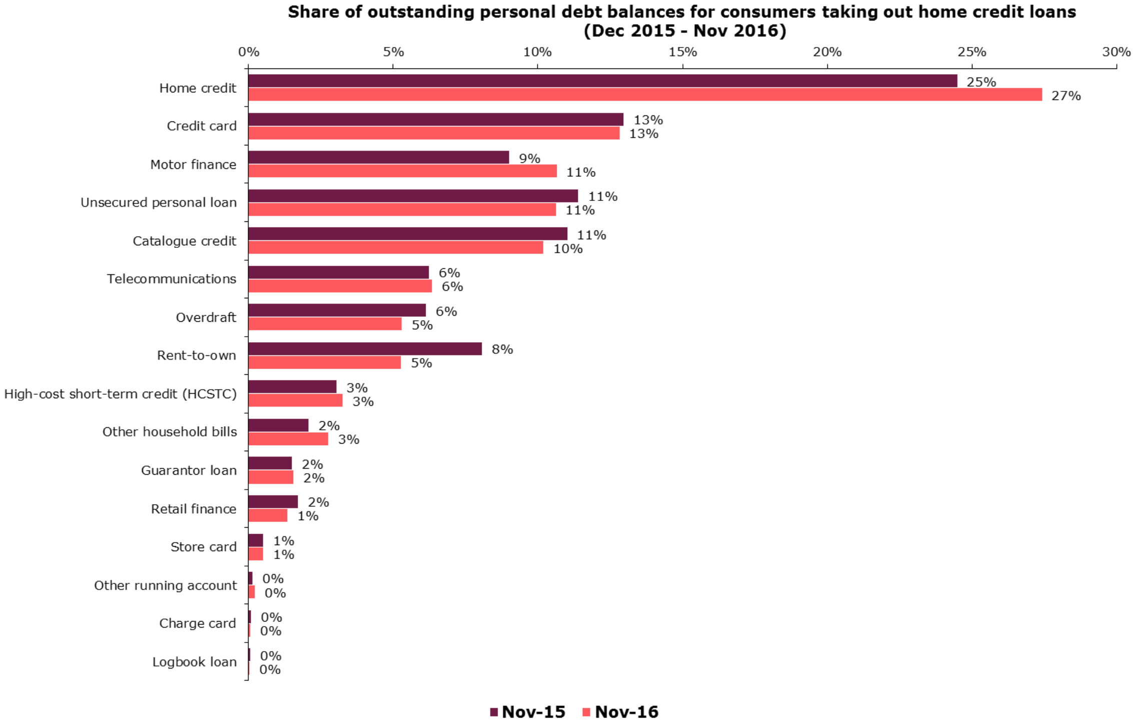
9.18 Among home credit borrowers, home credit is the prominent type of debt used by this customer base. It accounts for approximately a quarter of debt balances held by these customers at November 2015 and November 2016. A collection of a variety of products each account for near 10% of debt balances – catalogue credit, credit cards, motor finance and unsecured personal loans. Overdraft debts account for a noticeably smaller proportion of outstanding debts for these people compared to other high-cost credit products.

9.19 There are slight changes in the composition of these debt balances between November 2015 and November 2016 with rent-to-own and catalogue credit accounting for a smaller share while motor finance increases its share.

Table 17: Products held by borrowers taking out at least one home credit agreement between December 2015 and November 2016

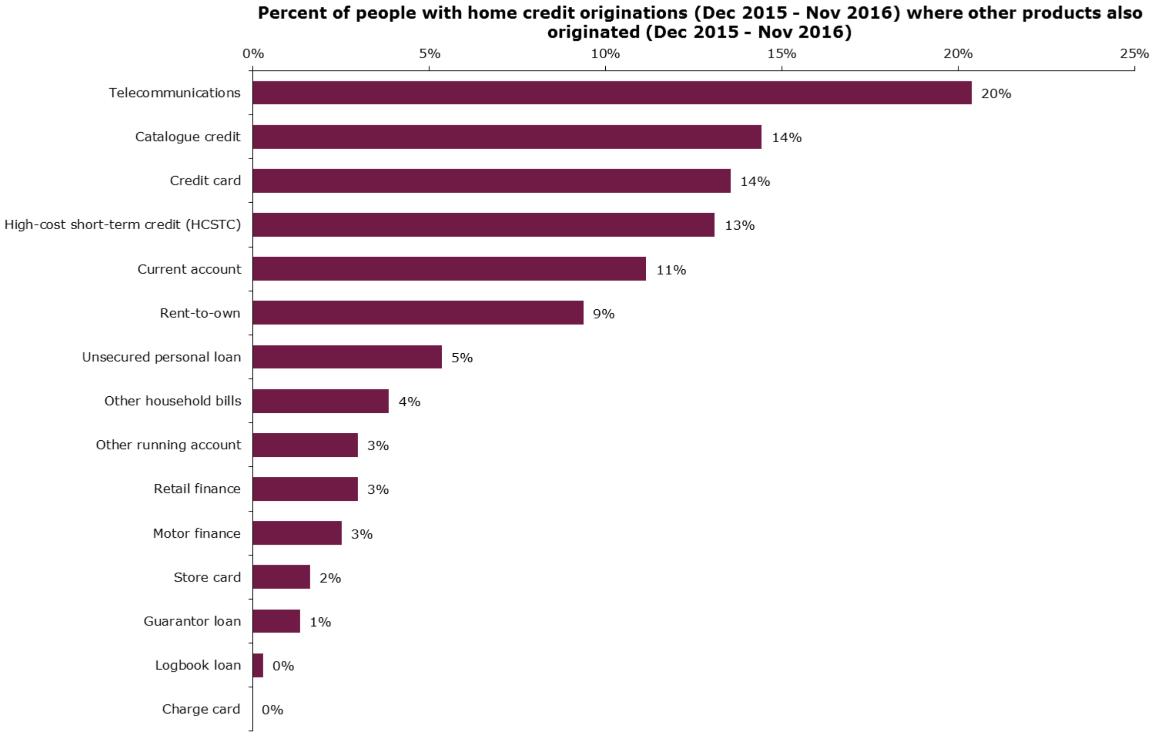
	Percent of home credit borrowers also holding debt on product as of…	
Product name	**November 2015**	**November 2016**
Home credit	70%	94%
Telecommunications	36%	40%
Catalogue credit	33%	40%
Credit card	29%	37%
Overdraft	29%	33%
High-cost short-term credit (HCSTC)	15%	19%
Unsecured personal loan	12%	17%
Other household bills	12%	16%
Rent-to-own	12%	12%
Motor finance	4%	6%
Retail finance	4%	5%
Mortgage	5%	5%
Store card	3%	5%
Other running account	2%	3%
Guarantor loan	1%	2%
Logbook loan	<1%	<1%
Charge card	<1%	<1%

Figure 78: Share of outstanding personal debt of home credit borrowers (December 2015 – November 2016) as of November 2015 and November 2016



9.20 Finally, we examine which other credit products home credit borrowers are taking out between December 2015 and November 2016. We observe that relatively few of these borrowers take out other credit products. One in seven take out a new credit card or catalogue credit agreement and one in eight a new HCSTC loan. Fewer than one in ten are taking out new unsecured personal loans or rent-to-own agreements. These borrowers rarely take out new motor or retail finance agreements.

Figure 79: Products originated by home credit borrowers (December 2015 – November 2016)

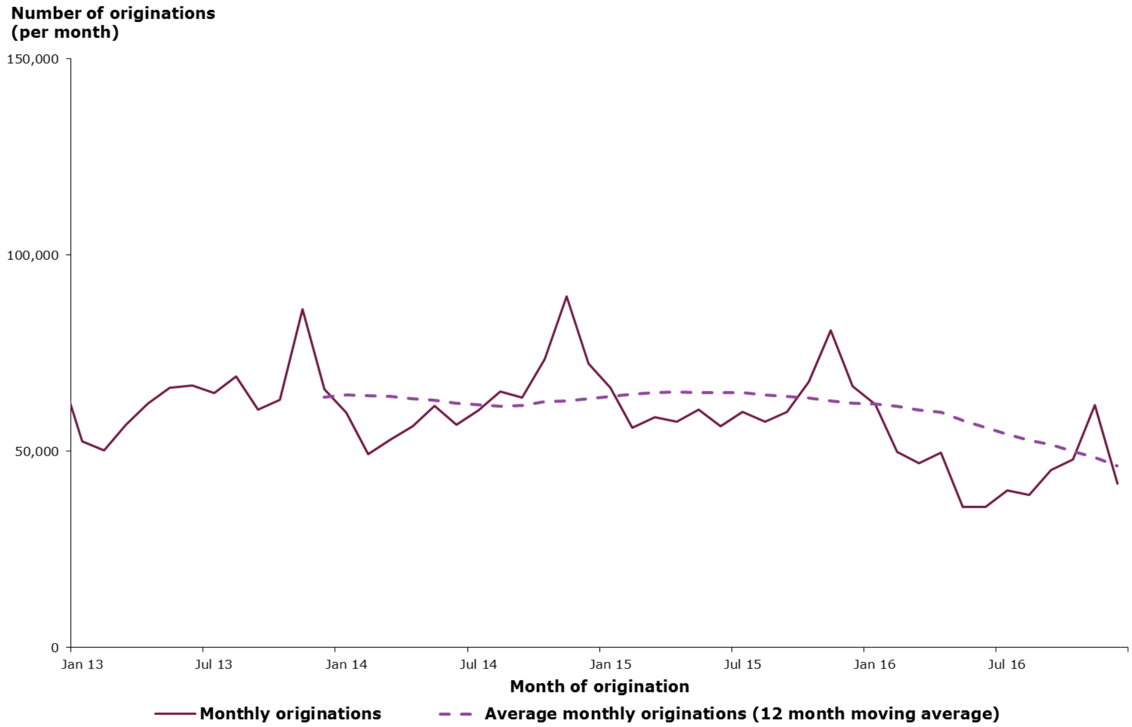


10 Rent-to-own

Market size

10.1 Rent-to-own loans are typically referred to as being hire purchase agreements whereby the borrower takes out credit to purchase a good – such as furniture, white goods, TVs - but does not gain ownership of the good until the last payment has been made.[43] During 2016, there were approximately 45,000 new rent-to-own loans taken out per month on average. There are seasonal variations revealed in Figure 80 – over the last few years around a fifth of annual lending occurs during November and December.

Figure 80: Number of rent-to-own originations (January 2013 – December 2016)



10.2 In 2016, just over 200,000 people took out one or more rent-to-own agreement. This is lower than 2013 to 2015 where the number of borrowers remained near to 250,000 per year. A larger number of people, 400,000, had outstanding rent-to-own debt on their credit file at the end of 2016 (taken out in 2016 or in previous years).

10.3 Table 18 displays the size of the rent-to-own market between 2013 and 2016. The £0.5bn value of total outstanding rent-to-own debt at the end of 2016 is a decrease on previous years. By a variety of measures the market broadly remained a similar size between 2013 and 2015. The market shrunk in 2016 and the average (mean) loan values slightly decreased below £1,100. By the end of 2016 relative to the end of 2015 the market had shrunk with over 26% and 28% falls in the number and value of lending respectively.

[43] http://www.appgdebt.org/wp-content/uploads/2015/03/APPG-RTO-Inquiry-report-10-2-15.pdf

Table 18: Size of rent-to-own market (2013 – 2016)[44]

	Number of consumers taking out product (millions)	Average (mean) value of originations	Number of originations (millions)	Value of originations (billions)	Value of outstanding debt (billions)
2013	0.2	£1,120	0.8	£0.9	£0.6
2014	0.2	£1,190	0.8	£0.9	£0.6
2015	0.2	£1,130	0.7	£0.9	£0.7
2016	0.2	£1,090	0.6	£0.6	£0.5

Credit performance

10.4 Delinquency rates on rent-to-own loans are relatively lower than some of the other less mainstream credit products potentially considered to be high-cost. Delinquency rates are highly seasonal based on the month of origination.

10.5 Figure 81 shows the proportion of rent-to-own agreements which enter arrears by vintage of origination. Here we observe more recent cohorts of originations - 2015 and the first half of 2016 - have higher delinquency rates than older vintages which plateaued at 7% or lower.

10.6 Figure 82 examines the proportion of rent-to-own agreements that enter default. Here we observe that defaults start after three months and there are noticeable differences in default rates across different vintages. 2015 agreements appear to be entering defaults faster than prior vintages but a lower proportion overall reach this stage.

10.7 We examine a variety of delinquency measures in Figure 83 for the 2015 vintage of lending. Approximately half of 2015 agreements missing two or more payments end in default and near 70% of earlier 2013 or 2014 cohorts. This shows that arrears and default rates follow a similar pattern and therefore indicates that it is likely for the recent rises in 2015 and 2016 arrears will eventually pass through into higher defaults. The speed at which it does so may depend upon the degree of forbearance offered and how effective this is at recovering debts and avoiding defaults.

[44] Data started in 2013 due to low coverage of the market in 2012.

Figure 81: Arrears rates by vintage of rent-to-own origination (January 2013 – June 2016)

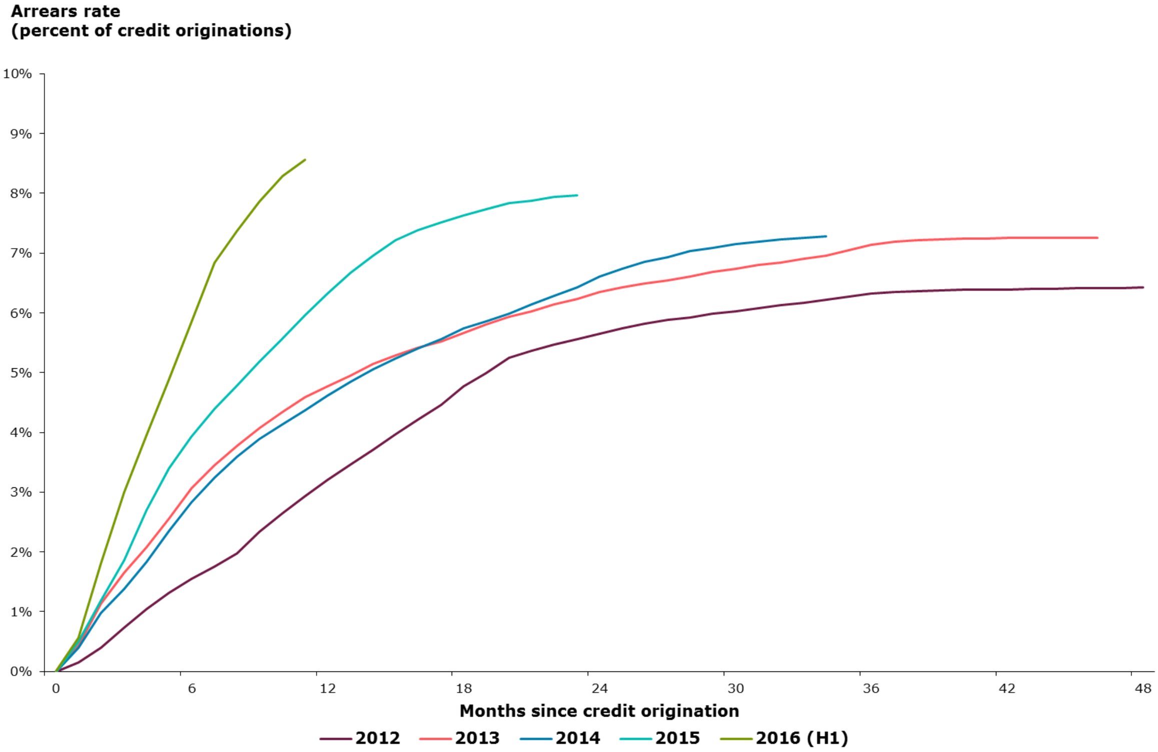


Figure 82: Default rates by vintage of rent-to-own origination (January 2013 – June 2016)

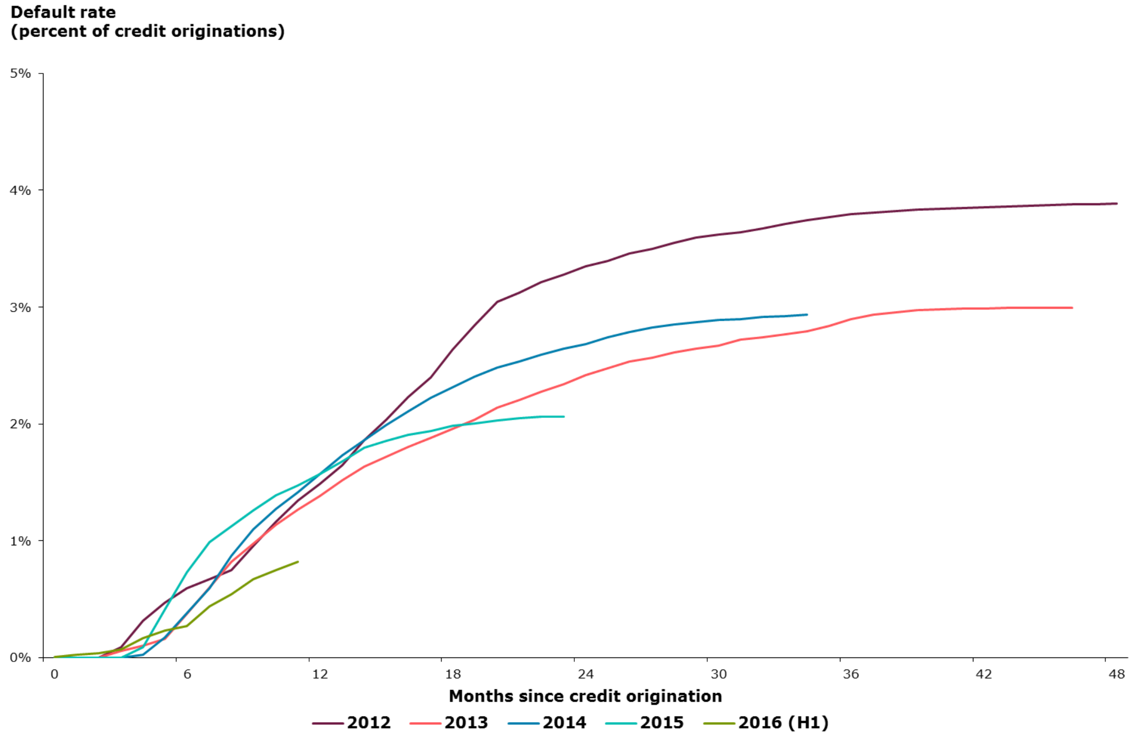
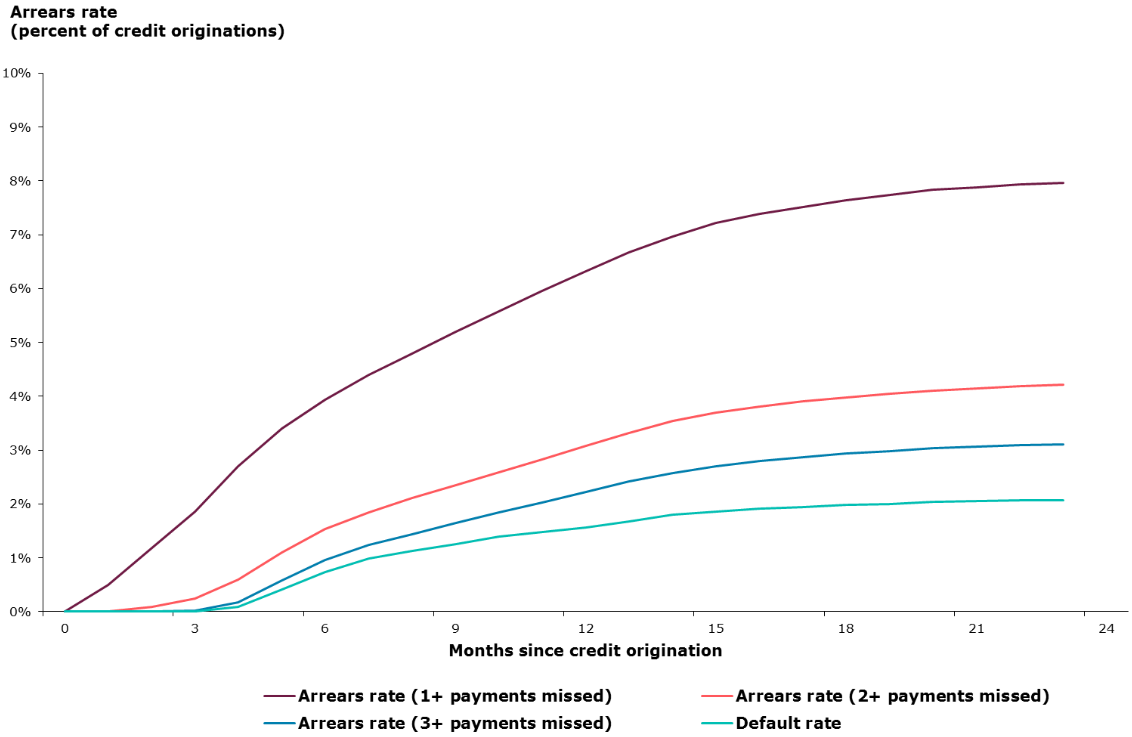
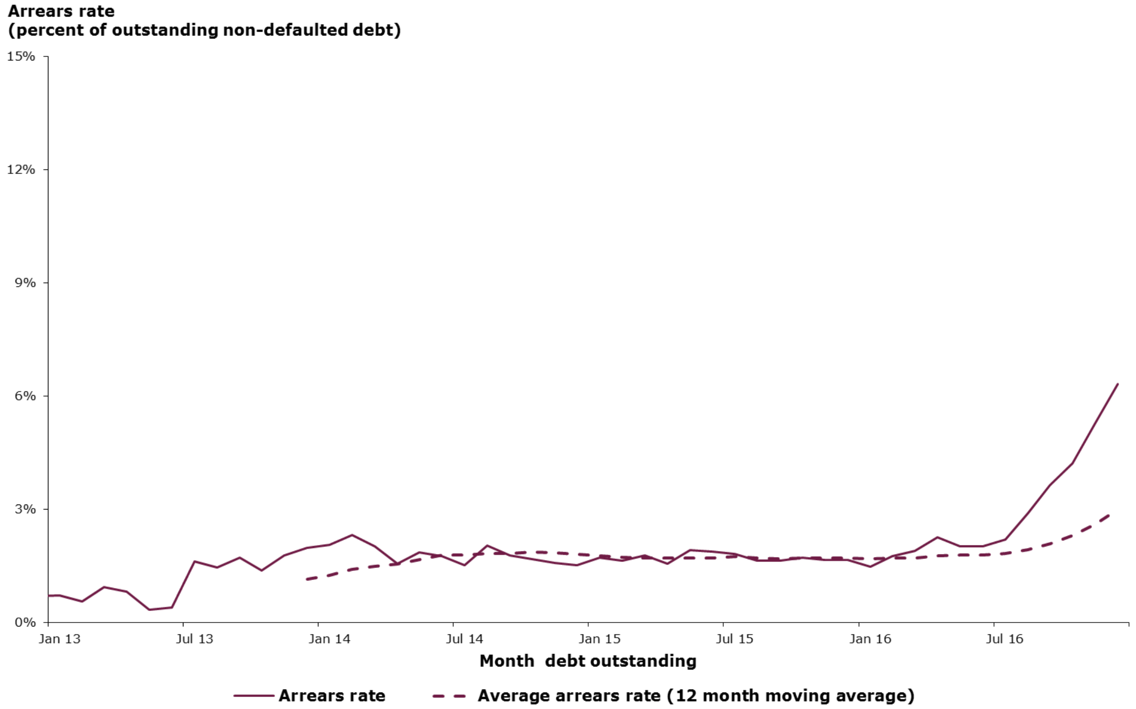


Figure 83: Stages of delinquency for 2015 rent-to-own origination vintage



10.8 The proportion of the total stock of outstanding, non-defaulted rent-to-own debt in arrears has been steady typically near 2% between 2014 and the start of 2015. The proportion of balances in arrears notably started to sharply increase during the latter half of 2016 (Figure 84).

Figure 84: Outstanding stock of delinquent rent-to-own loans (January 2014 – December 2016)



10.9 The repeated consumer use of rent-to-own agreements displays a very similar pattern to the home credit market. We find that over 45% of people using this product in 2016 took out one loan that year while the median was two loans a year. Around one quarter of rent-to-own customers took out two loans, over 10% three loans and 2% took out 12 or more loans – these figures have not substantively changed between 2015 and 2016 (see Figure 85).

10.10 Comparing these to the number of rent-to-own products these individuals have outstanding debts on - in Figure 86 – finds a slightly different pattern. Only a third of borrowers have a single rent-to-own loan outstanding with over 20% of borrowers having four or more rent-to-own debts outstanding.

Figure 85: Distribution of rent-to-own loan originations per borrower (2015, 2016)

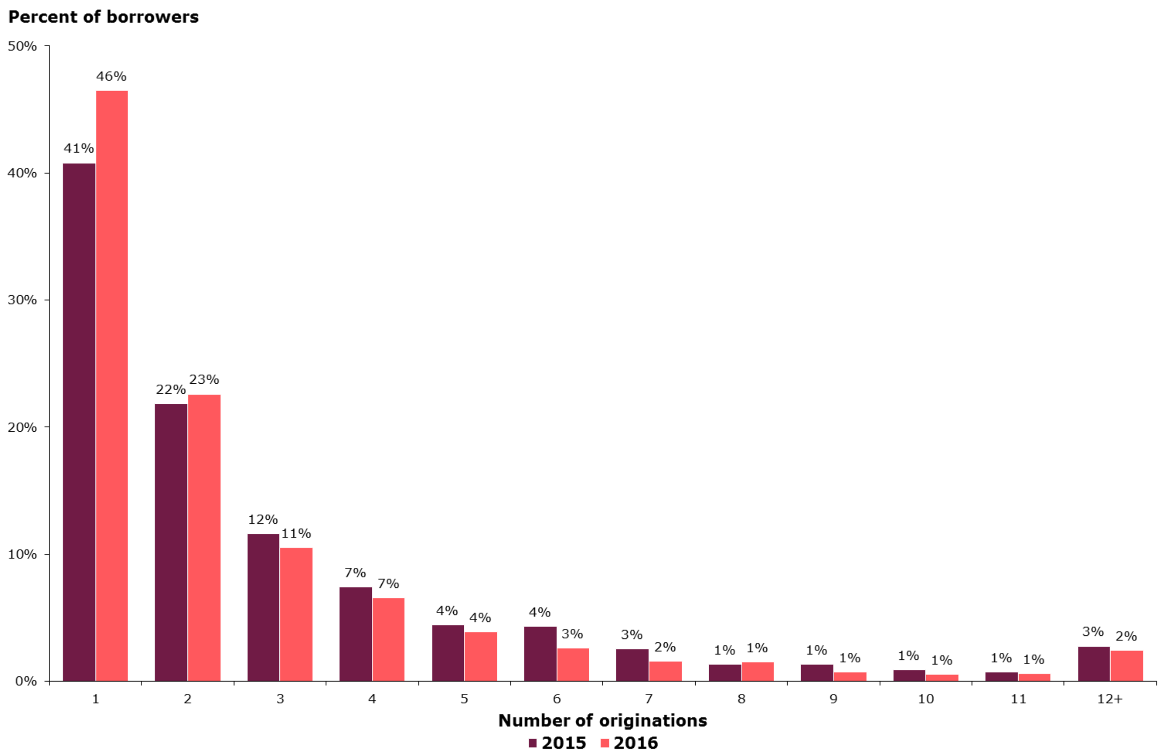
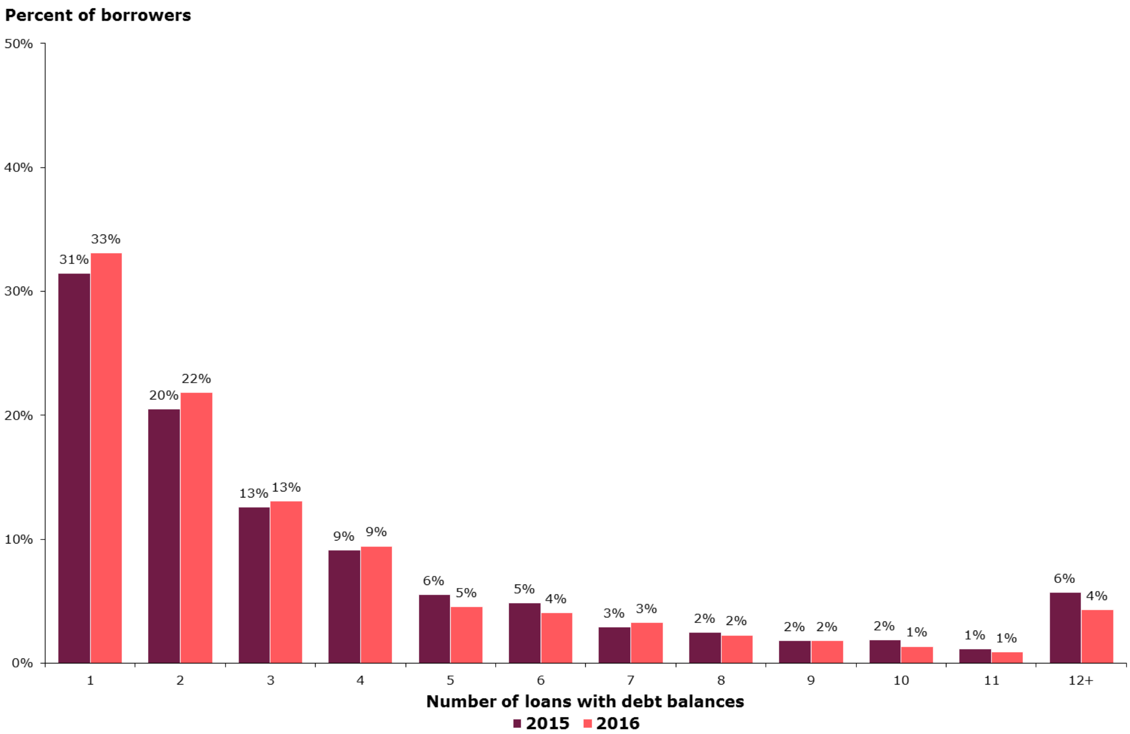
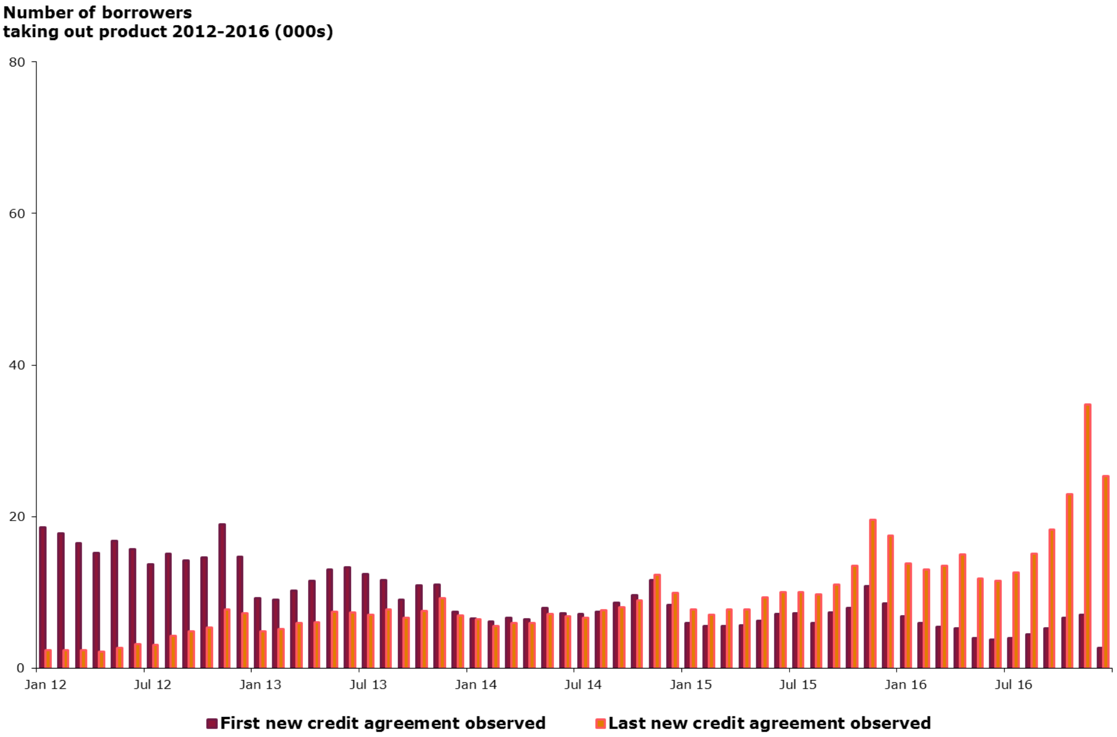


Figure 86: Distribution of number of rent-to-own loans outstanding among borrowers with outstanding rent-to-own debt (2015, 2016)



10.11 Figure 87 displays when we first and last observe consumers taking out a new rent-to-own agreement in our data. This shows that there are a relatively stable (and small) number of people who are new rent-to-own borrowers each month. Towards the end of 2016 we observe a higher number of people taking out their last rent-to-own agreement. This points towards an established customer base built up over time around a core group of people who repeatedly borrow.

Figure 87: Date rent-to-own borrowers are first and last observed taking out a new rent-to-own agreement between January 2012 and November 2016



Consumer circumstances

10.12 Rent-to-own borrowers have a younger age profile to home credit users. These rent-to-own borrowers have a mean and median average age of 39 and 36 respectively. Borrowers have slightly higher incomes compared to the home credit market but these are still quite low. Estimated mean and median annual, net individual incomes of borrowers taking out rent-to-own agreements in 2016 were £18,400 and £16,100 respectively. For 8% of borrowers we do not observe an income estimate.

10.13 Figure 88 compares the credit score profiles of 2016 rent-to-own borrowers to those who had taken out these agreements previously in 2012, 2013 or 2014 but not in 2015 or 2016. The credit scores of these borrowers are worse than those using home credit or HCSTC. A significant number of people are very close to the bottom end of the credit score distribution. By comparison, former users of these products have noticeably higher, though still not very high, credit scores.

10.14 Examining the debts of 2016 borrowers displays that, as of November 2014, over 15% of people who would go on to take out a rent-to-own agreement in 2016 had no outstanding personal debt. By November 2016, less than 5% of these borrowers had no outstanding personal debt. The borrower with median amount of outstanding debt more than doubled from £2,000 to £4,300 November 2014 to November 2016. And when we order these same people by their outstanding debts we observe that the top 25% of borrowers had at least £4,300 in debt in November 2014 compared to at least £7,300 by November 2016.

10.15 The median ratio of outstanding personal debt to estimated annual, net individual incomes (DTI ratio) similarly increases from 14% to 29% January 2015 to January 2017. This is significantly higher than some of the other less mainstream credit products. Figure 89 shows the distribution of DTI ratio for 2016 borrowers compared to former borrowers – the former group have noticeably higher DTI ratios on average.

Figure 88: January 2017 credit score of 2016 rent-to-own borrowers and former rent-to-own borrowers (borrowing rent-to-own in 2012-2014 but not in 2015 or 2016), dotted line for mean

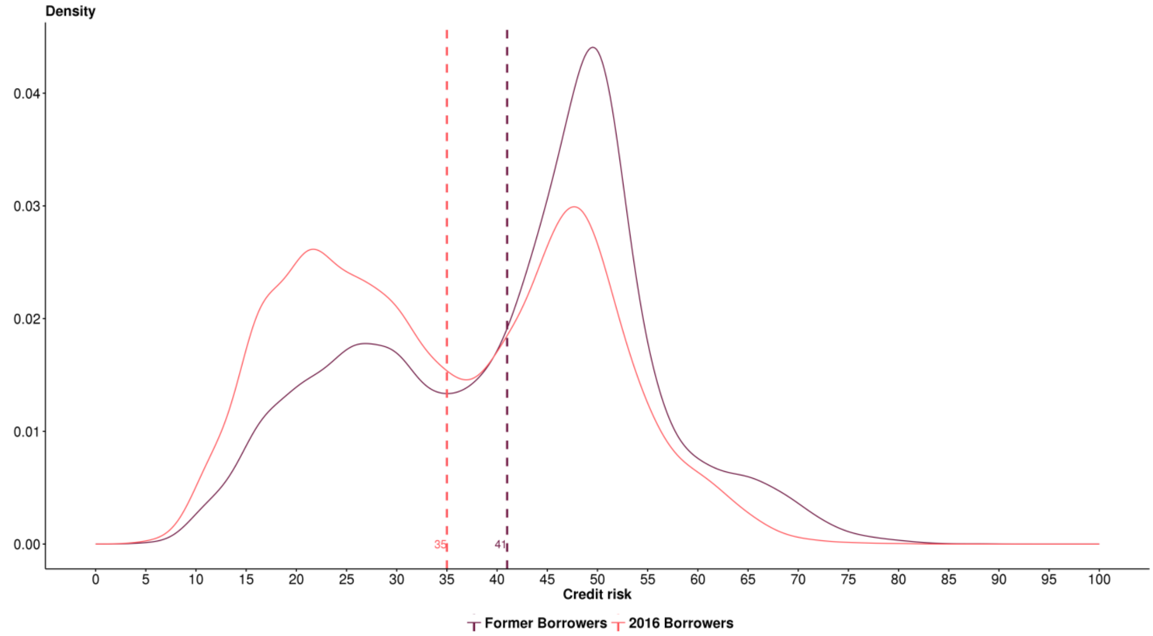
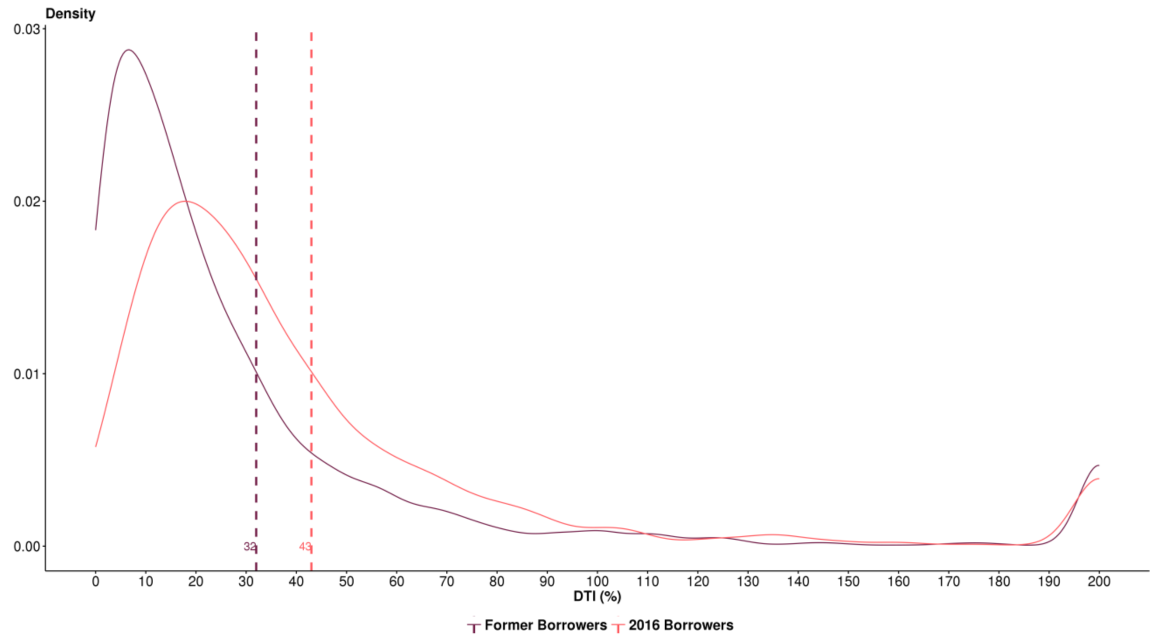


Figure 89: Distribution of January 2017 DTI ratio of 2016 rent-to-own borrowers and former rent-to-own borrowers (borrowing rent-to-own in 2012-2014 but not in 2015 or 2016), dotted line for mean



10.16 Among consumers taking out rent-to-own agreements during 2016 the median number of credit items (any form of personal debt) with outstanding debt on in November 2016 was eight – up from four in November 2014. The top 10% of people had outstanding personal debt on sixteen or more products – up from eleven two years' prior to this. Of credit items not in default, the median borrower had four credit items with outstanding personal debt in November 2014 and top 10% had ten or more.

10.17 We explore the composition of debts held by consumers taking out rent-to-own agreements in greater detail to understand the interactions between products and how these change over time. Table 19 shows the proportion of rent-to-own borrowers (taking out an agreement between December 2015 and November 2016) who hold debt on other products as of November 2015 and November 2016. Of those taking out rent-to-own agreements, the majority, 62% already had outstanding rent-to-own debt in November 2015 and 86% still had outstanding debt by November 2016.

10.18 Fewer than one in thirty rent-to-own borrowers have mortgage debt. Focusing on personal debt we observe that the proportion of borrowers with debts on quite a few types of credit increases from November 2014 and November 2016.

10.19 Just under half of borrowers have home credit debt in November 2014 and this increases to just over half by November 2016. 37% of borrowers had catalogue credit debt in November 2015 and this increases to 46% in November 2016.

10.20 Credit card debt and overdraft debt are also common with an increasing proportion of people holding debts on these products over time. There are other especially noticeable increases in the proportion of individuals with outstanding telecommunications debt or other household bill debt – such debt is typically in arrears or default.

Table 19: Products held by borrowers taking out at least one rent-to-own agreement between December 2015 and November 2016

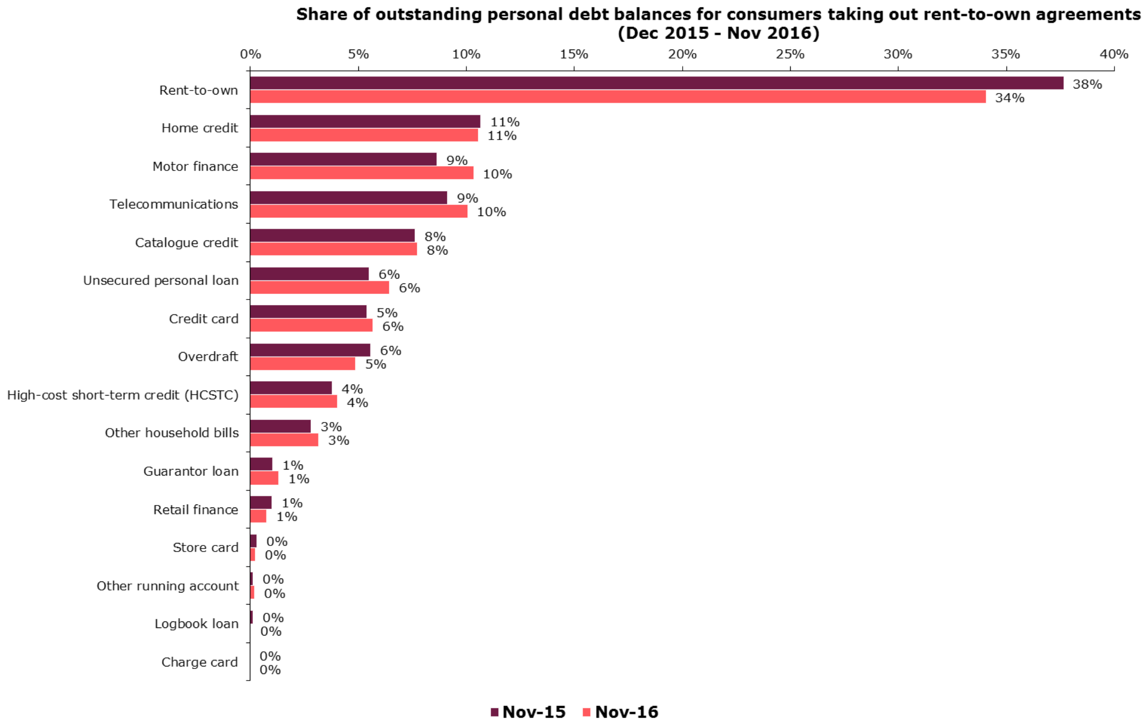
	Percent of rent-to-own borrowers also holding debt on product as of…	
Product name	**November 2015**	**November 2016**
Rent-to-own	62%	86%
Telecommunications	53%	61%
Home credit	46%	52%
Catalogue credit	37%	46%
Overdraft	36%	40%
Credit card	27%	37%
High-cost short-term credit (HCSTC)	24%	30%
Other household bills	16%	21%
Unsecured personal loan	12%	20%
Motor finance	5%	8%
Retail finance	3%	4%
Store card	3%	4%
Other running account	2%	3%
Mortgage	3%	2%
Guarantor loan	1%	2%
Logbook loan	<1%	<1%
Charge card	<1%	<1%

10.21 Examining the debt balances of these borrowers in Figure 90 displays that rent-to-own is the prominent type of debt used by this customer base. It accounts for over a third of debt balances held by these customers at November 2015 and November 2016.

10.22 A variety of other debts each account for close to 10% of debt balances – catalogue credit, home credit, motor finance and telecommunications debt. Compared to users of other products, only a relatively small fraction of these people's debts are made up of credit cards, overdrafts or unsecured personal loans.

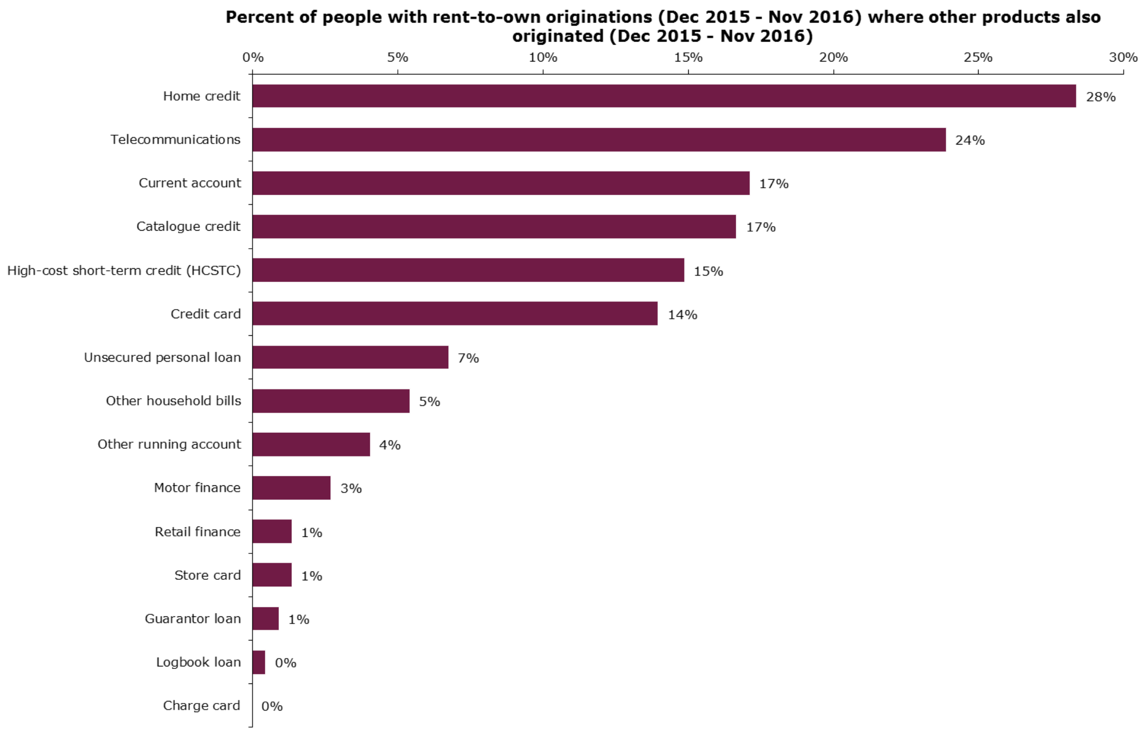
10.23 There are slight changes in the composition of these debt balances between November 2015 and November 2016 with rent-to-own accounting for a decreasing share while credit card, motor finance and telecommunications slightly their shares.

Figure 90: Share of outstanding personal debt of rent-to-own borrowers (December 2015 – November 2016) as of November 2015 and November 2016



10.24 Figure 91 examines the flow of newly originated debts by rent-to-own borrowers and shows that it is fairly common for them to take out new home credit agreements – 28% do so. Between one in six and one in seven take out new credit card, current accounts, HCSTC or catalogue credit agreements.

Figure 91: Products originated by rent-to-own borrowers (December 2015 – November 2016)

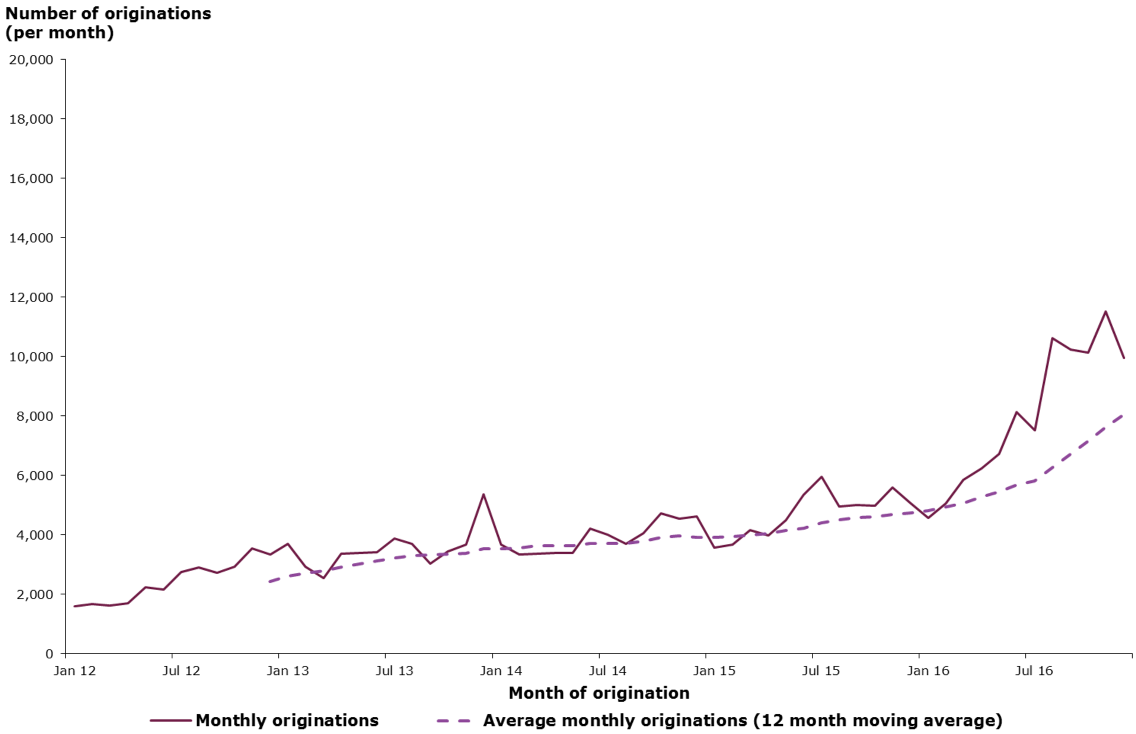


11 Guarantor

Market size

11.1 Guarantor loans are when a borrower takes out a credit agreement as part of which another individual has guaranteed payment if the borrower does not make payment.[45] While having a guarantor on lending agreements is relatively established in a number of countries, in the UK it has only started to become established fairly recently. This market remains quite small - during 2016, there were approximately 8,000 new guarantor loan agreements taken out per month on average. However, it is rapidly growing over time – especially in 2016 as displayed in Figure 92.

Figure 92: Number of guarantor loan originations (January 2012 – December 2016)



11.2 In 2016, nearly 80,000 people took out a guarantor loan. This is almost three times as many as in 2012 (though it was starting from a small base number of people). This represented a 50% increase year-on-year from 2015.

11.3 The relative infancy of this market means that the number of people holding guarantor loan debts is also increasing over time. This increased from fewer than 60,000 people in 2012 to over 135,000 people in 2016. There were over 5,000 new borrowers entering this market per month towards the end of 2016 which is a noticeable increase on the number of new borrowers in 2014 or 2015 which was closer to averaging 2,500 people each month.

11.4 Table 20 summarises how this market has changed between 2012 and 2016. In 2016, the number and value of guarantor loan originations reached a new high of 100,000 loans worth £380 million. These loans are large in size with the average

[45] Guarantor loans are when an individual takes out a loan as part of which a different individual agrees to guarantee the payment of that debt. A formal legal definition: https://www.fca.org.uk/publication/guidance-consultation/gc16-07.pdf

(mean) origination amount in 2016 being almost £4,000. These loans are also increasing in size with loans issued in 2016 being 10% larger, on average, than a year earlier. The £440 million value of total outstanding guarantor loan debt at the end of 2016 is a notable increase on previous years - £220 million and £300 million in 2014 and 2015 respectively.

Table 20: Size of guarantor loan market (2012 – 2016)

	Number of consumers taking out product (millions)	**Average (mean) value of originations**	**Number of originations (millions)**	**Value of originations (billions)**	**Value of outstanding debt (billions)**
2012	0.03	£3,250	0.03	£0.10	£0.13
2013	0.04	£3,260	0.04	£0.14	£0.17
2014	0.04	£3,430	0.05	£0.16	£0.22
2015	0.05	£3,570	0.06	£0.20	£0.30
2016	0.08	£3,940	0.10	£0.38	£0.44

Credit performance

11.5 The credit performance of monthly vintages of guarantor loans issued are quite volatile – partially due to the relatively small number of loans issued compared to some of the other less mainstream markets.

11.6 Figure 93 shows arrears rates by cohort of guarantor loan origination. We treat 2012 and 2013 loan vintages with caution given the relatively small number of loans observed in this period. However, we observe a general trend of increasing proportions in arrears from around 15% in 2012 and 2013 to closer to 20% in 2014 and nearer to 25% in 2015. The vintage of loans from the first half of 2016 appear to be closely tracking the path of the 2015 vintage.

11.7 Default rates of these guarantor loan vintages are examined in Figure 94. The 2015 loan vintage stands out as being significantly higher than other cohorts which plateau close to 1%.

11.8 The default rates on guarantor loans are lower than many other less mainstream credit products. This is partially likely to be a result of the unique feature of guarantor lending – rather than the loan ending in default responsibility for paying is shifted to the guarantor (and there is likely to be social pressure on the borrower to not require their guarantor to pay on their behalf).

11.9 A variety of measures of delinquency are examined in Figure 95 for the 2015 guarantor loan vintage. Here we observe a large gap between the proportion of loans which miss one (or more) payment and those which miss two (or more payments) or enter default. For example, for the 2015 vintage, 30% of guarantor loans which miss two or more payments eventually end up in default (this figure varies for other vintages).

Figure 93: Arrears rates by vintage of guarantor loan origination (January 2012 – June 2016)

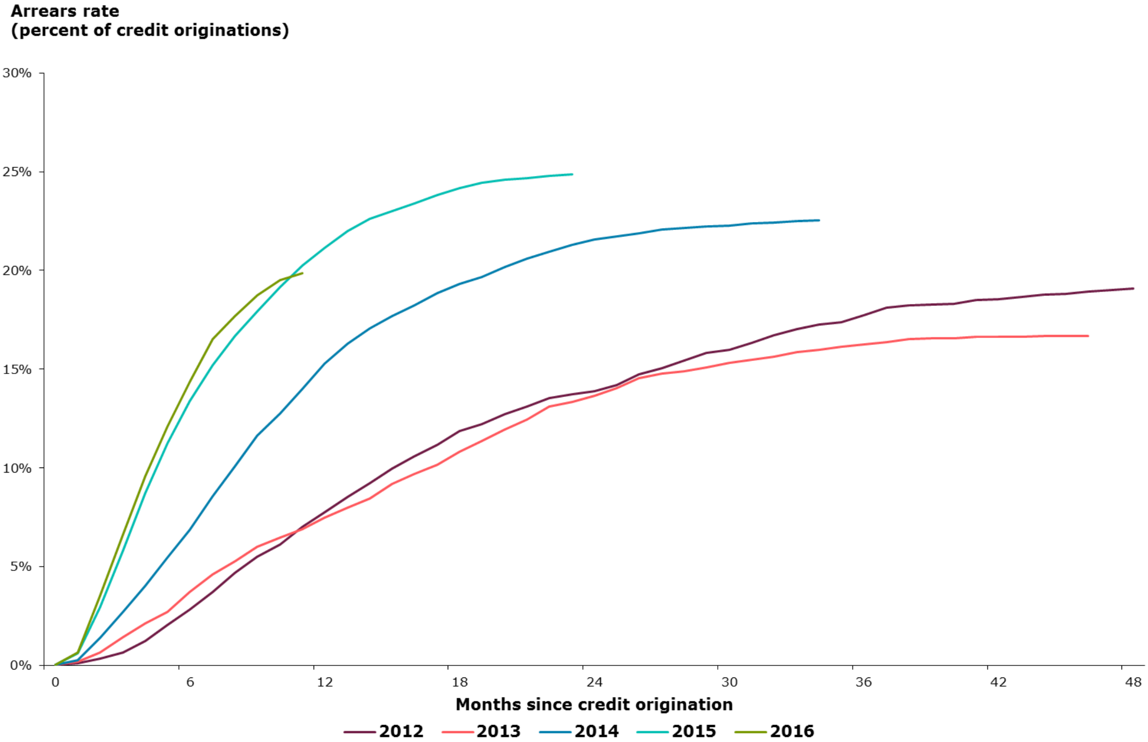


Figure 94: Default rates by vintage of guarantor loan origination (January 2012 – June 2016)

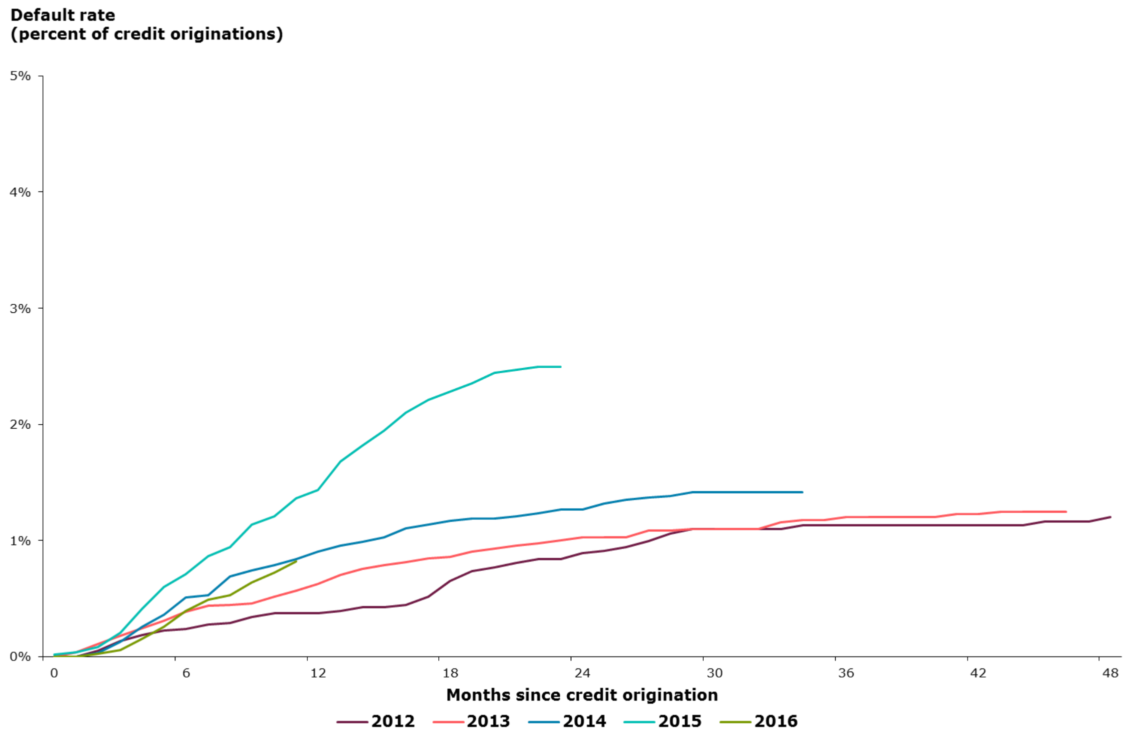
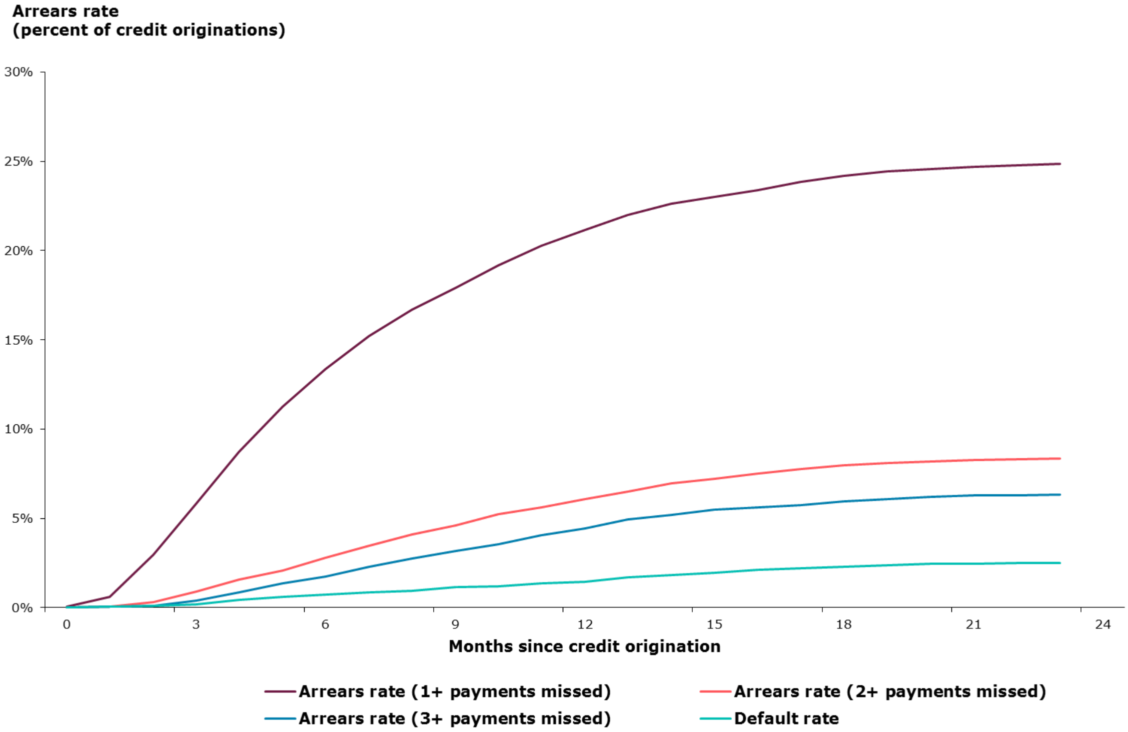
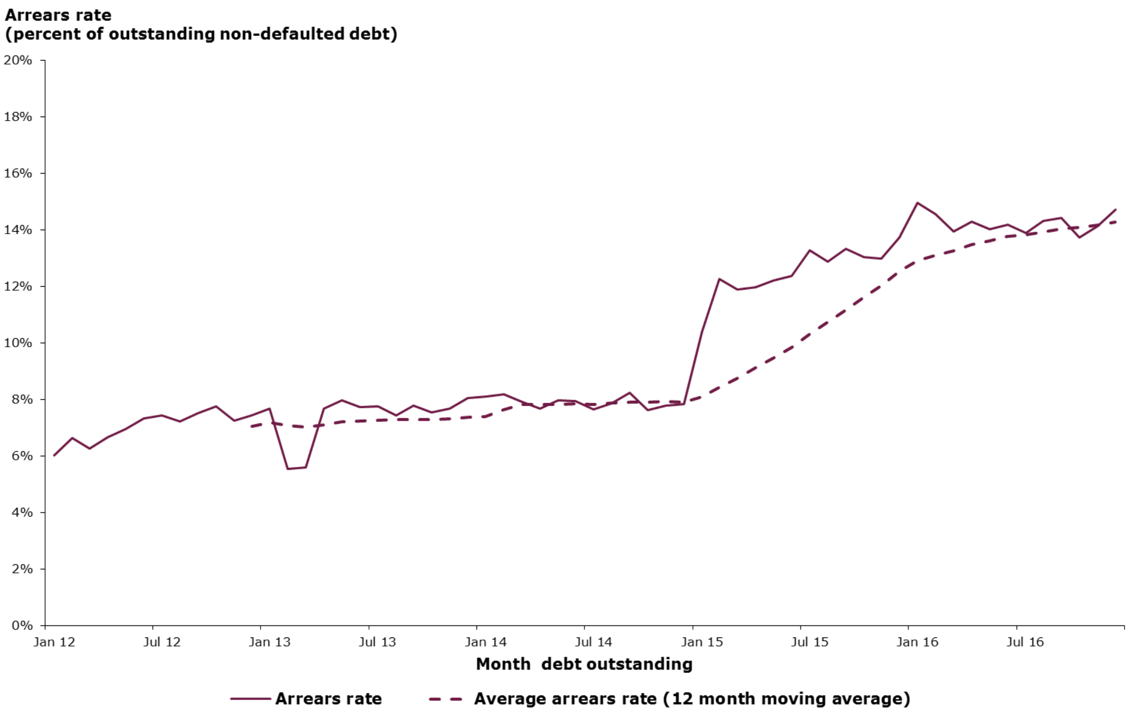


Figure 95: Stages of delinquency for 2015 guarantor loan origination vintage



11.10 The total stock of outstanding non-defaulted guarantor loan debt in arrears between 2012 and 2016 is displayed in Figure 96. This shows how at the end of 2016 almost 15% of debt was in arrears. The time series for this market is difficult to interpret as there was a one-off change in arrears levels at the start of 2015.

Figure 96: Outstanding stock of delinquent guarantor loan debt (January 2012 – December 2016)



11.11 The distribution of guarantor loans among consumers displays a similar pattern to retail finance. Over 80% of people taking out guarantor loans took out exactly one agreement during 2016. As shown in Figure 97 this has started to change in 2016 – with a growing proportion of borrowers taking out multiple guarantor loans in a year. For example, 15% of people took out two guarantor loans in 2016 compared to 10% in 2015 – this is quite a large shift especially considering that this occurred while the market was rapidly growing.

11.12 Figure 98 shows the number of guarantor loan debts held by consumers with guarantor loans. Comparing this distribution that showing the previous charts shows a similar pattern between 2015 and 2016. Here we also see the overwhelming majority of people using guarantor loans having debt on one of these products but there have been noticeable increases in the proportions with outstanding debts on multiple guarantor loans in 2016 compared to 2015. At the end of 2016, 78% had outstanding guarantor loan debt on one product which is down from 83% at the end of 2015. At the end of 2016, 17% of guarantor loan borrowers had outstanding guarantor loan debt on two products and 5% had outstanding debt on three or more guarantor loan products.

11.13 Figure 99 shows the first and last date we observe a customer taking out a new guarantor loan between 2012 and 2016. The date of last loans being observed closely tracks the levels for the date of first loans being observed – as would be expected given how common it is to have a single guarantor loan. The noticeable aspect of this chart is how the number of new borrowers is increasing over time. This shows that new individuals are taking out these products as the market is growing.

Figure 97: Distribution of guarantor loan originations per borrower (2015, 2016)

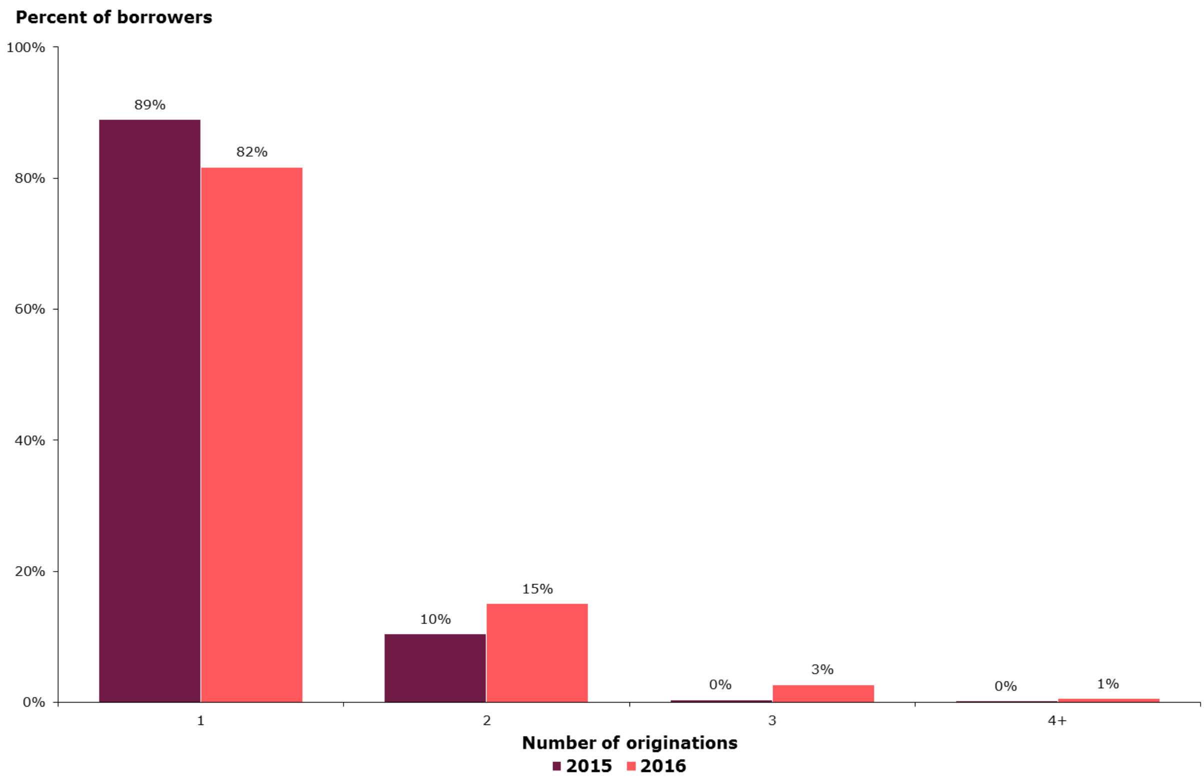


Figure 98: Distribution of number of guarantor loans outstanding among borrowers with outstanding guarantor loan debt (2015, 2016)

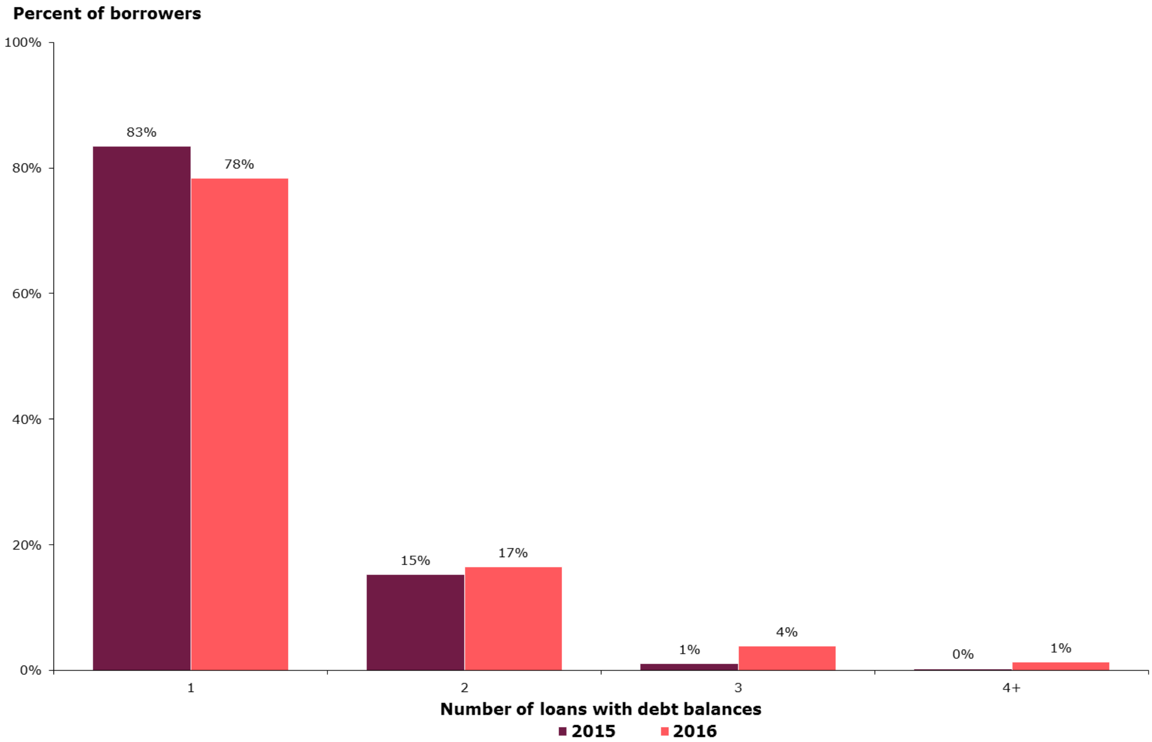
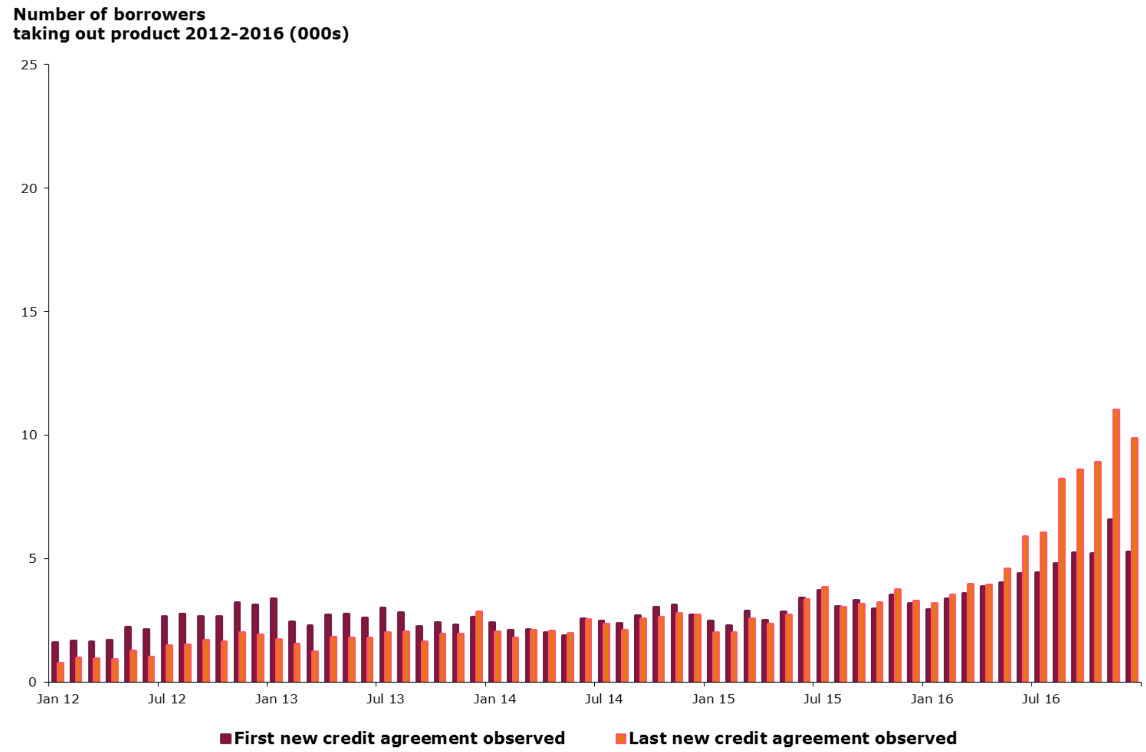


Figure 99: Date guarantor loan borrowers are first and last observed taking out a new guarantor loan between January 2012 and November 2016



Consumer circumstances

11.14 Borrowers taking out guarantor loans have a mean and median average age of 35 and 33 respectively. These estimated mean and median annual, net individual incomes of these borrowers are £26,100 and £20,800 respectively.[46]

11.15 When we examine the credit score profile of people taking out guarantor loans agreements we observe that they have quite low credit scores. Given the recent growth of this market, there are relatively few former users of these products, who took out guarantor loans in 2012, 2013 or 2014 but did not do so in 2015 or 2016, but these people typically have higher credit scores. These are displayed in Figure 100.

11.16 Examining the debts of 2016 borrowers displays that as of November 2014, over 20% of people who would go on to take out a guarantor loan in 2016 had no outstanding personal debt. By November 2016, almost none of these borrowers had no outstanding personal debt. The borrower with median amount of outstanding debt increased from £1,600 to £7,400 November 2014 to November 2016. When we order these same people by their outstanding debts we observe that the top 25% of borrowers had at least £4,700 in debt in November 2014 compared to at least £13,500 by November 2016.

11.17 The DTI ratio displays the ratio of outstanding personal debt to estimated annual, net individual incomes. The median DTI ratio for 2016 guarantor loan borrowers has significantly increased from 9.5% to 32.1% from January 2015 to January 2017. Figure 101 shows the distribution of the January 2017 DTI ratio for 2016 guarantor loan borrowers compared to former borrowers.

11.18 Among consumers taking out guarantor loans during 2016 the median number of credit items (any form of personal debt) with outstanding debt on in November 2016 was six – up from three in November 2014. The top 10% of people had outstanding personal debt on thirteen or more products – up from seven two years' prior to this. Of credit items not in default, the median borrower had four credit items with outstanding personal debt in November 2016 and top 10% had nine or more.

11.19 When we analyse the other debts people taking out guarantor loans in 2016 hold this displays that one in ten has outstanding mortgage debt. Back in November 2015, a quarter of people taking out guarantor loans in 2016 already had guarantor loan debt and this increases to 85% by November 2016. Nearly half have credit card or overdraft debt outstanding and over 30% have HCSTC or catalogue credit. There is an especially noticeable, large increase the proportion of people with credit card debt to 65% in November 2016.

[46] We do not observe an income estimate for 1% of borrowers

Figure 100: January 2017 credit score of 2016 guarantor loan borrowers and former guarantor loan borrowers (borrowing guarantor loan in 2012-2014 but not in 2015 or 2016), dotted line for mean

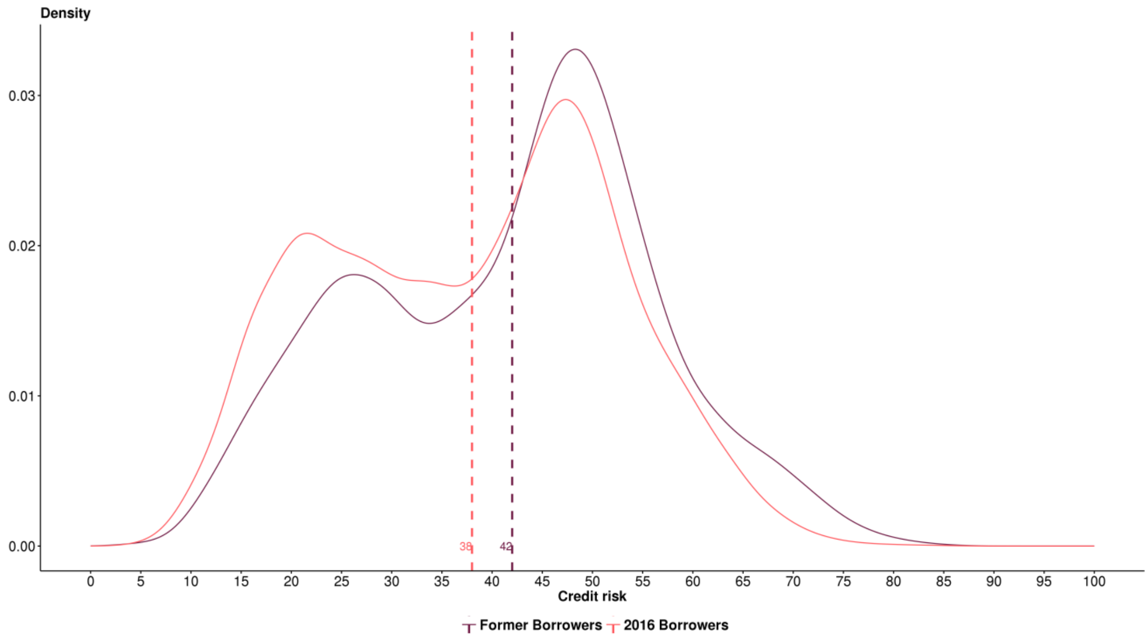


Figure 101: Distribution of January 2017 DTI ratio of 2016 guarantor loan borrowers and former guarantor loan borrowers (borrowing guarantor loan in 2012-2014 but not in 2015 or 2016), dotted line for mean

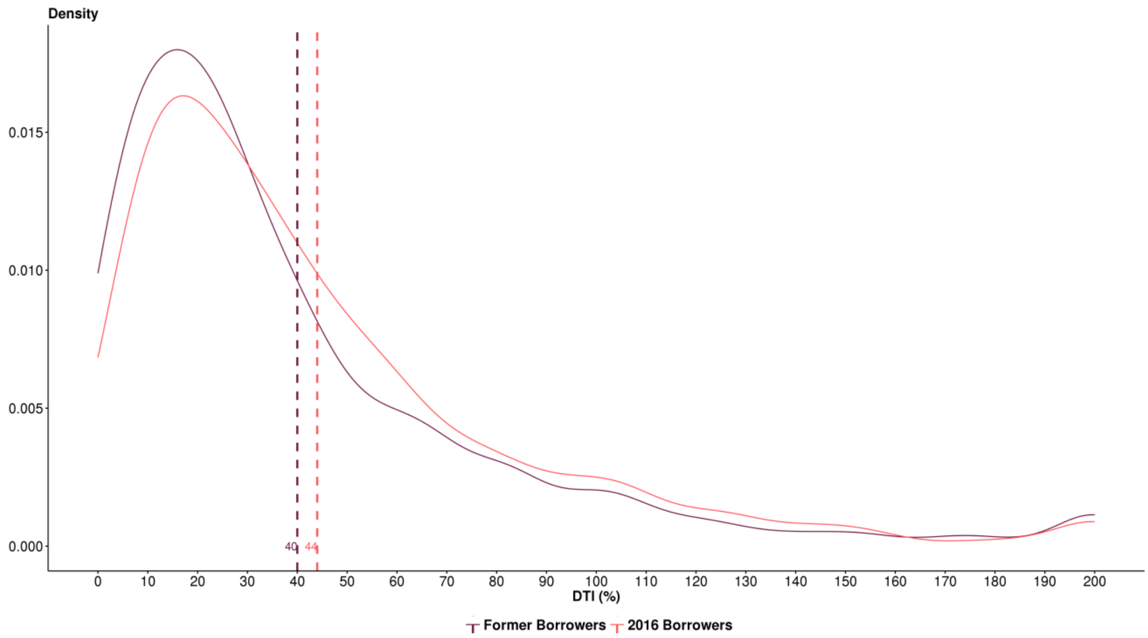


Table 21: Products held by borrowers taking out a least one guarantor loan between December 2015 and November 2016

	Percent of guarantor loan borrowers also holding debt on product as of…	
Product name	**November 2015**	**November 2016**
Guarantor loan	25%	85%
Credit card	49%	65%
Overdraft	47%	54%
Telecommunications	40%	45%
High-cost short-term credit (HCSTC)	31%	43%
Catalogue credit	30%	38%
Unsecured personal loan	22%	29%
Home credit	14%	18%
Motor finance	10%	15%
Other household bills	12%	13%
Other running account	4%	11%
Mortgage	11%	10%
Retail finance	9%	10%
Store card	5%	7%
Rent-to-own	5%	5%
Logbook loan	<1%	<1%
Charge card	<1%	<1%

11.20 When we analyse the share of outstanding debt balances we see that guarantor loans account for a significant proportion of the outstanding personal debt of such people as shown in Figure 102. While guarantor loan debt accounted for 14% of the outstanding personal debt of these people in November 2015 this had increased to 32% in November 2016. Credit cards, unsecured personal loans and motor finance account for a large proportion of outstanding debts – these shares decrease in November 2016 as the share of guarantor loan debt increases.

11.21 Finally, we look at the other new credit originations by these individuals between December 2015 and November 2016. This shows that over one in three are taking out new credit cards and one in five new current accounts. Approximately 30% are taking out new HCSTC loans. A variety of other products are opened by 12-16% of these borrowers as shown in Figure 103.

Figure 102: Share of outstanding personal debt of guarantor loan borrowers (December 2015 – November 2016) as of November 2015 and November 2016

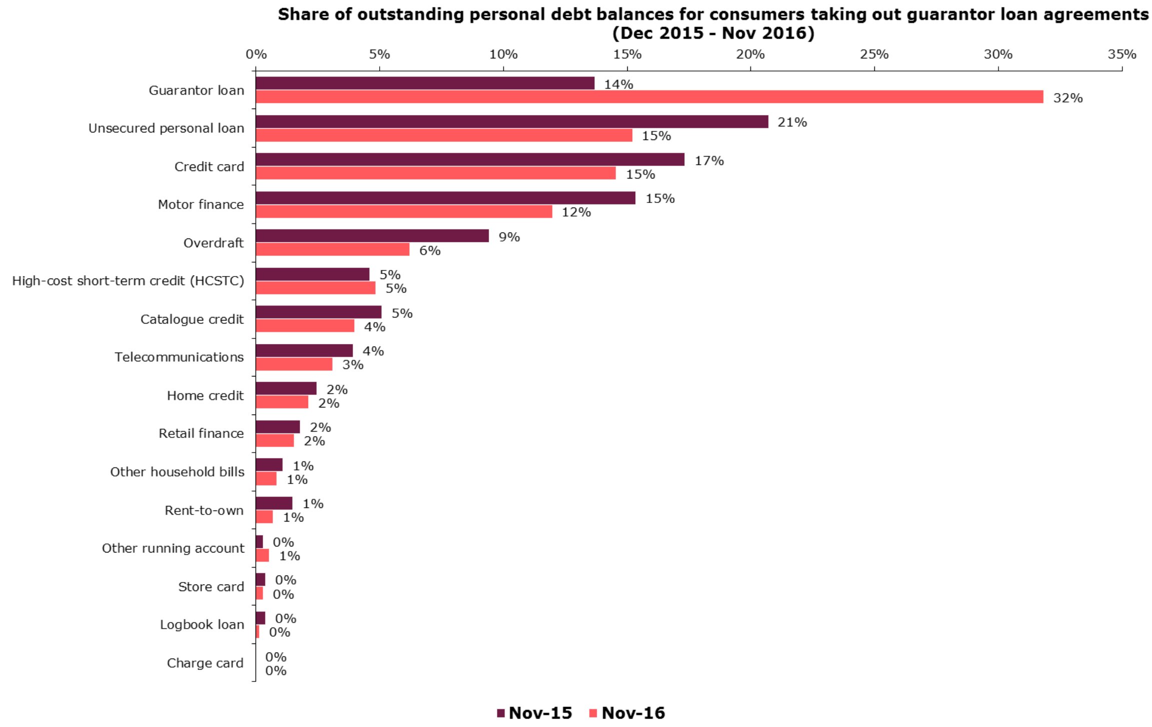
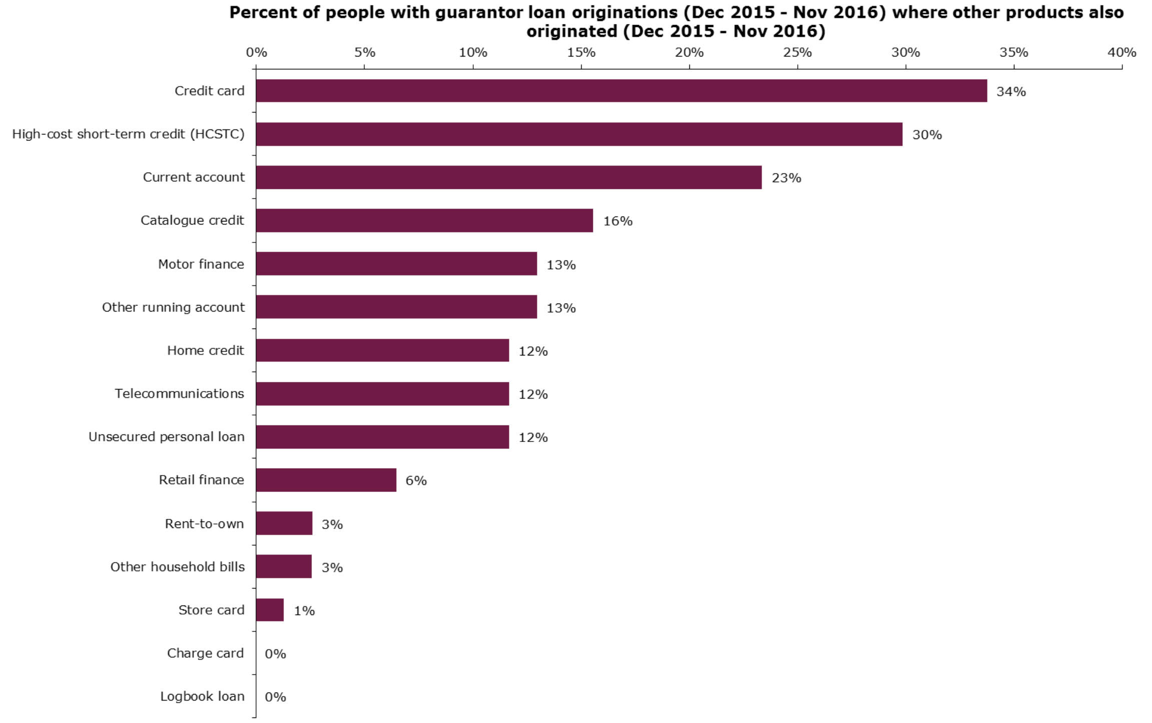


Figure 103: Products originated by guarantor loan borrowers (December 2015 – November 2016)



Appendix 1. Details of credit reference agency (CRA) data

Data sample

3. The FCA used its statutory powers to require credit reference agencies to provide data.[47] These data consisted of a 10% representative sample of individuals who are contained in credit reference agency (CRA) data.[48] In addition, data was collected on people these individuals were associated with (e.g. joint mortgage holders) in CRA data. The full credit files were gathered for each of these individuals covering all credit items held by an individual and reported to a CRA at any point between March 2011 and February 2017.

4. The sampling was created for the high-cost credit review as well as being used for a broader array of purposes by the FCA for its on-going regulation of retail lending and retail banking markets. One example of these other applications has been joint work with the Bank of England to understand the drivers of recent consumer credit growth and potential financial stability, prudential and conduct risks arising from this.

5. These data are representative of credit files as of the time it was collected and include all of an individual's credit items recorded on their credit file as of that date - those which have been outstanding at any point over the last six years. We are aware that some motor finance lenders and utility bill providers are not contained in these data and therefore these debts are under-represented. Some smaller lenders also do not appear.

6. Further back in time these data increasingly underestimate the size of total, outstanding personal debt for a variety of reasons:

   - These data do not include credit records where lenders do not report to the CRA. We observe in these data it is noticeably more common for firms to appear in CRA data after 2014 - when consumer credit lending came under FCA regulation and firms started to become authorised - than before this time. Primarily for this reason we do not report earlier data for some products.

   - Defaulted loans are removed from CRA data once they have been in default for six years from the date of default. This means that for each additional month we go back in these data we do not observe defaults that occurred six years plus one month previously (and would have been visible had these data been constructed at that time).

[47] CRA data has previously been used by the FCA for a variety of projects. This started with the work setting of the high-cost short-term credit (HCSTC) price cap in 2014 – see technical annex 3 (pages 156-226):

https://www.fca.org.uk/publication/consultation/cp-14-10-technical-annexes.pdf

and a similar sample was collected for conducting analysis for the 2016 Call for Input for the High-cost credit review – see Annex 3 (pages 37-59):

https://www.fca.org.uk/publication/call-for-input/call-input-high-cost-short-term-credit.pdf

[48] Checks were carried out at the time of constructing the sample to ensure it would be representative of the overall population. For some of the analysis we use sub-samples of these data (e.g. HCSTC loans or a 10% sample of individuals in the 10% sample) to improve efficiencies when carrying out analysis. The sampling strategy was based upon that used by the Federal Reserve Bank of New York:

https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr479.pdf

- In cases where lenders have ceased to operate, these records no longer appear unless the debt is purchased and serviced by a debt collector who chooses to report to a CRA.
- There are particular cases where credit records have been removed or changed as part of redress exercises or consumer complaints.
- We do not observe the debts of individuals who used to be in CRA data but are no longer – most commonly due to being deceased.

7. Particular caveats accompany specific CRA datasets (the datasets are explained in the next sub-section). Current account turnover data is a fairly new innovation and therefore further back in time fewer firms were reporting these data and the dataset was still evolving. Separately, while it is common for lenders to report their portfolio of debts to two or three CRAs this does not mean they routinely carry out a credit check with all of these and therefore the data recording credit searches has lower coverage of the overall market than the portfolio dataset.

Data description

8. CRA data consists of a several datasets and the precise structure of these varies across different CRAs. A generic summary is provided in Table 22. These data from each of these datasets were collected for all individuals in the sample described above. Each individual in these data contains a numerical identifier enabling us to match records from the different datasets for that individual.

9. These data collected by the FCA did not include names, addresses, bank account or credit card details. Date of birth and postcode were collected to enable demographic profiling and matching to other FCA-held datasets.

Table 22: CRA datasets

Datasets	Description
Portfolio data	Each credit item reported to a CRA is recorded here. This includes new credit items originated over the last six years and older agreements which were still active during this time. These data contain details of origination (including firm name, open date, open amount, product type) and performance data including outstanding balances, credit limits, repayments and arrears status. (data covers up to 72 months)
Credit card behavioural data	For credit cards we observe monthly data on the number and value of cash advances, a flag for whether a consumer only paid the contractual minimum payment and a flag whether the card is subject to a promotional offer. (data covers up to 24 months)
Current account turnover (CATO) data	For current accounts we observe

Datasets	Description
	monthly data on the value of payments into accounts. (data covers up to 24 months)
Credit application data	'Hard' credit searches and 'soft' quotation searches are both observed along with basic information about the search. For example, in some cases this includes income reported when lenders carry out a credit search. (daily data covers up to six years)
Public data	Public data on personal insolvencies - e.g. county court judgements, debt relief orders and bankruptcies. (daily data covers up to six years)
CRA-created metrics	For two points-in-time we observe a range of CRA-created metrics including credit risk scores and income estimates. (January 2015 and January 2017)

Data cleaning

10. These data were collected in March 2017, however, due to data reporting lags the last complete portfolio data across credit items are observed in November 2016.[49] Some credit items contain data for December 2016, January and February 2017. In our measures of arrears and default rates by cohort we capture whether or not credit agreements had entered arrears or default during this time.

11. Each credit item in a credit file was classified to one of the product categories and names listed in Table 23 using a combination of information about products and lenders. Pawnbroking is not observed in CRA data. We exclude credit items listed as SME finance from our analysis.[50] Please note that these classifications may change over time as these categorisations may be less suitable for other analysis.

Table 23: Product names

Product category	Product name
Mortgages	- Mortgage - Second charge mortgage
Mainstream credit	- Credit card - Current account (and overdrafts) - Motor finance

[49] See FCA Occasional Paper No.28 for more details of such reporting lags.

[50] Large SME finance agreements would typically appear on commercial credit files.

Product category	Product name
	- Unsecured personal loan
Less mainstream credit	- Catalogue credit - Charge card - Guarantor loan - High-cost short-term credit (HCSTC) - Home credit - Logbook loan - Other running account - Retail finance - Rent-to-own - Store card
Utilities	- Telecommunications - Other household bills
Small and medium-sized enterprises (SME) finance	- SME finance

12. Origination amount is taken as the credit limit at origination for revolving products – credit cards, overdrafts, store cards, catalogue credit and other running account. For non-revolving credit items where the origination amount is zero or missing this is imputed with the first non-zero balance recorded in the credit file.[51]

13. In cases where no non-zero balances were recorded in the portfolio data for that credit item we take the median origination amount for loan originations that month by that firm.[52] For mortgages, the month at which an account is closed is recorded with a zero balance in order to prevent double-counting of mortgage debt in that month between the account that has been closed and another one opened due to refinancing or moving property. Where loan origination dates are missing these are imputed using the first date that credit item is observed in the portfolio data.

14. For credit cards we calculate outstanding debt as the statement balance less repayments made against this. For all credit items balances, repayments and credit limits are bounded at zero and, in the cases where repayments are observed, these are bounded to be no greater than the value of outstanding balance.

15. For consumer-level analysis observations where basic information about an individual (e.g. date of birth, postcode) is missing are dropped.[53] These are typically old records with little or no outstanding debt attached to them. When carrying out product-level analysis these observations are kept.

[51] This is not applied to utilities.

[52] As above.

[53] We expect these individuals to typically be appearing in the data elsewhere with a complete record which the CRA is unable to accurately match to these historic credit items where data is missing.

16. We extrapolate from this sample of data to estimate how our analysis translates to the overall personal debt. We extrapolate the number of individuals by multiplying by 10. When extrapolating statistics based on the number or value of credit items we need to account for the appearance of joint accounts which are duplicated. We do this by multiplying by 10 and dividing this result by the number of account holders in order to ensure we do not double count joint accounts.[54] While checks were done for representativeness against the population the sample was selected from there remains potential – this is most likely to impact extrapolations of balances recorded on low incidence credit agreements.

17. Estimated annual, net individual incomes are constructed using a combination of incomes reported on application forms and flows of money into current accounts. These income estimates are used with the caveats highlighted in FCA Occasional Paper No. 20 as these are often not derived from verified incomes. A significant minority of people using less mainstream credit products do not have any estimates of income. Where estimated incomes are greater than £200,000 these are top-coded to this value.

18. Where an income estimate is present we calculate the debt-to-income (DTI) ratio taking outstanding personal debt in either November 2014 or November 2016 and dividing by incomes at January 2015 or January 2017 respectively. For constructing the DTI ratio we use outstanding personal debt in November 2016 as opposed to January 2017 (or December 2016) because reporting lags mean there is incomplete debt coverage in these months and would therefore under-report the DTI ratio. Given seasonality in these markets we use November for both 2014/15 and 2016/17 DTI ratios. Where the DTI ratio is greater than 2 we top-code to this value.[55] Where there is no outstanding personal debt and no income estimate the DTI ratio is put to zero. Finally, where there is outstanding personal debt but no income estimate the DTI ratio is unable to be calculated.

19. We use measures of delinquency as firms report in CRA data.[56] More recent arrears have had less time to be amended by consumers if they were mistakenly reported by the lender. Stages of arrears range from one to six missed payments as well as when credit items are classified as being in default. For some products, such as home-credit, where payments are weekly rather than monthly these stages of arrears are monthly equivalents. For example, an arrear on a home credit agreement is therefore reported if a consumer has missed the equivalent to the value of one month's payment (4.33 weeks).

[54] If this does not produce an integer we round up to the next integer.

[55] Total, outstanding personal debt is also top-coded to £200,000 for this calculation.

[56] http://www.scoronline.co.uk/sites/default/files/High%20Level%20Prinicples%20Document%20Version%202%20final.pdf