UK's financial regulator back on policymaking form

Blog post by Practice Lead Tom Smith, 1 August 2017

The publication this week of a review into the UK's high-cost credit market is just the latest demonstration of the UK's financial services regulator, the Financial Conduct Authority (FCA) regaining its mojo for activist policymaking. The FCA has always held a formal objective of protecting consumers, but this has often had to be balanced against the economic and political interests of the financial services sector. The weakness of the current government therefore gives the FCA an opportunity to return to a proactive approach, although maybe not the "shoot first and ask questions later" attitude of its first CEO, Martin Wheatley.

The FCA has had a turbulent existence since its formation in 2013. An initial bout of regulatory activism was quashed by then Chancellor, George Osborne, prompting the defenestration of the regulator's senior management team. Osborne's Mansion House speech in 2015 was seen by many as signalling the high-water mark in the stringency of financial services regulation and that government leadership would informally restrain the independent regulator from developing its consumer protection theme at the expense of market growth and competitiveness.

This review's findings appear to vindicate the regulator's pre-2015 interventionism on high-cost credit; a cap on fees has not decimated competition or blocked lower-income borrowers from accessing credit as some had feared. The FCA argues this has tipped the balance from lenders to consumers, to the tune of £150m a year. The report goes on to argue that more needed to be done for the sector to act in the best interests of consumers, both on prompting more robust assessment of borrowers by firms and on reducing fees and charges.

With the government's own mandate for policy innovation, and more importantly its political capital and capability for reigning in the FCA's recommendations now undermined, the FCA has the opportunity to regulate more, acting as a market shaper above and beyond the payday lending sector that was the focus of earlier intervention. Home-collected credit, catalogue credit and rent-to-own products all cause concern for the regulator, alongside criticism of fees for unarranged overdrafts.

All of these products face an existential threat from regulatory action, with formal proposals for FCA intervention to be published in the spring, next year. While retail banks are already managing their revenue from overdraft fees away from this regulatory risk, firms active in the less mainstream and more specialist consumer credit sub-sectors, many of which enjoy private equity backing, could encounter more substantial difficulties.

The FCA also hints at a yet further degree of policy intervention. On rent-to-own, for example, it suggests a similar product should be provided through the non-profit sector. It is then only a small step until the regulator is recommending alterations to the configuration of welfare spending programmes. The government currently provides interest free budgeting loans of up to £812 to certain benefit recipients. Reprofiling the functioning of welfare payments to include a credit facility, which provides financial support to in and out of work low-income families, could be far more efficient and return the improved consumer outcomes the FCA is aiming for. The question will be whether the government's lack of authority will prompt the regulator to more forcefully make these suggestions.

For now, the FCA's focus will be on unarranged overdraft fees, and a likely ban put forward for consultation early next year could well see further reshaping of the retail banking market. How radical those proposals are will be a guide to how interventionist the regulator will be on reviews scheduled for the next 18 months on, *inter alia*, motor finance, wholesale insurance, retail banking and the mortgages market. Should the Treasury continue to be distracted by the rigours of Brexit and minority government, it could be the experts of the FCA making the running on the contours of the policy landscape for the next few years.

UK consumer credit market – less mainstream credit products

Product Name	Average value of credit originated	Average value of outstanding debt per credit item	Annual number of consumers taking out product (million)	Number of consumers with outstanding debt (million)	Value of outstanding debt (billion)	Median credit score (0-100, 0 = more likely to default)
Catalogue Credit	£320	£360	1.9	7.6	£4.0	63
Guarantor Loan	£3,900	£3,430	0.1	0.1	£0.3	40
High-cost Short-term Credit	£290	£390	0.8	1.6	£1.1	42
Home Credit	£760	£550	0.7	1.6	£1.1	41
Logbook Loan	£2,980	£2,320	<0.1	<0.1	<£0.1	32
Other Running Account	£680	£270	0.2	0.3	£1.0	54
Retail Finance	£1,790	£1,170	2.3	5.3	£6.0	69
Rent-to-own	£1,120	£650	0.2	0.4	£0.5	35
Store Card	£560	£220	0.4	1.9	£0.7	65