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**PRESS RELEASE**

# CLIMBING THE CREDIT LADDER

## PAYDAY LOANS SHOULD HELP THE POOR NOT PENALISE THEM

## ResPublica calls for reform of the short-term finance market so it helps people escape the debt trap and improve their credit ratings

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Payday loans have rightly been subjected to a lot of regulation and reform that has eliminated much of what was wrong in the industry. But ResPublica believe reform could and should go much further. Too often those who use payday loans are captive consumers – nobody else will lend to them and they cannot escape high charges and short term credit even if they are good customers who repay their loans on time. ResPublica wants to open up the rest of the credit market to these customers so that over time they can improve their credit profile and access cheaper finance and longer term loans. This will change payday loans from an industry that is seen as capitalising on peoples troubles to one that actually helps transform and improve people's lives.

A radical overhaul of the consumer credit market is needed to help those taking out payday loans improve their credit ratings, and could even help them take their first step on the property ladder. These are the conclusions of ResPublica's latest report, **Climbing the Credit Ladder: Short-term loans as a path to long-term credit**.

The report argues that by helping to improve the credit history of those in financial need, people can escape reliance on short-term loans and move towards long-term credit products that could help them stabilise their finances. This would lead to improved financial stability and could ultimately see those on lower incomes enter the property market.

**Cathy Jamieson MP, Shadow Financial Secretary to the Treasury**, supports the report's recommendations. She said, "The stigma surrounding short-term credit is such that some customers may find it difficult to access more mainstream forms of credit in the future. It is important to acknowledge that short-term loans can be used responsibly. The integration of the short-term lending sector with the wider consumer credit market through a 'credit ladder' is one possible solution."

**Mark Garnier MP**, Member, Treasury Select Committee and co-founder, APPG on Financial Education for Young People, commented, "It's incredibly expensive to be poor. If the payday lending sector could fulfil a social, even virtuous, function, helping rather than penalising those on lower incomes, it would be more than simply a barrier to illegal money-lenders."

**Phillip Blond, Director of ResPublica**, commented: "The current short-term finance market exacts too high a penalty on poorest consumers. Instead it should and could be economically and socially transformative, allowing people to climb the credit ladder towards financial stability.

Simply banning short terms loans, which people do need, will only push families into the hands of the loans sharks – better to recalibrate the industry as a second-chance credit institution that can help build back peoples financial lives."

The report finds:

- **Credit scoring penalises the poor**

Every credit search leaves a footprint on a customer's credit history, and too many footprints can be seen as negative and can lead to penalties, including rejection of mortgage applications. Poorer consumers are more likely to have negative credit scores and the more searches that are conducted on their files, the worse their history gets, and they become trapped in a cycle of debt. But consumers should be encouraged to shop around for the best deals. More detailed credit scoring using behavioural consumption behaviour, and greater use of quotation searches which don't leave a footprint, will create a fairer market for consumers.

- **Defaulters should be put directly and immediately through to a debt advisory service**

Almost 9 million people in the UK are 'over-indebted', yet less than a quarter seek advice for their debt problems. Consumers who fail to pay for any credit should be referred to a free advisory service, either the Money Advisory Service or an independent debt advice charity. This referral should happen at the time of non-payment to ensure that consumers benefit from the advice. We believe where consumers default they should be telephoned by the loan company and through them they should be put directly in touch with an advisory service. At the moment consumers are simply encouraged to get help and many never pick up the phone to access the help that is already out there.

- **All debt should come with a strong 'danger to your financial health' warning**

Consumers must be told the truth about credit. Unauthorised overdrafts, for example, are the most widely used form of short term credit. Yet unauthorised overdrafts are actually more expensive than payday loans. We want consumers to know about this so they can make genuinely informed decisions about their debt. All forms of debt should come with a strong warning to consumers.

- **Better judge the level of risk**

Assessing whether a consumer will pay back a loan on time can be done by looking at how they consume. Banks are already sitting on vast amounts of data on consumer consumption behaviour. Banks should be encouraged to share this information with loan companies to determine whether a consumer is a good risk or not. This move would particularly benefit those in real need, because loan companies would be able to separate a working parent who may be short of money to pay a large electricity bill from someone who wants money for a night out. This is similar to the system adopted by mortgages lenders, where applicants are asked lifestyle questions such as 'do you have a gym membership?' to gauge whether they can manage their budgets.

- **Lenders should reward good borrowers**

Consumers who regularly repay loans on time should be rewarded. Payday lenders currently give some 'good risk' customers larger loans at the same rate, but we think this should go further. Consumers who prove they are credit-worthy should be rewarded with cheaper loans, because this will lead to greater future financial stability, allowing them to progress into mainstream credit.

- ENDS -

**Notes to the Editor:**

1. *Climbing the Credit Ladder: Short-term loans as a path to long-term credit* will be available for free download from www.respublica.org.uk on Monday 3rd November 2014.

2. The report will be launched on Monday 3rd November at 2pm in the Wilson Room, Portcullis House, with a panel discussion featuring Cathy Jamieson MP, Shadow Financial Secretary to the Treasury, and Mark Garnier MP, Treasury Select Committee.

3. The ResPublica Trust (which operates under the trading name ResPublica) is an independent, non-partisan think tank. We focus on developing practical solutions to enduring socio-economic and cultural problems in the UK. Our practical recommendations for policy implementation seek to strengthen the links between individuals, institutions and communities that create both human and social capital.

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