EXECUTIVE INSIGHTS

Improving Access to Lending for the Financially Vulnerable — an Urgent Call to Action for the Consumer Lending Industry and Its Ecosystem

The Woolard Review, published in 2021, was a far-reaching review across both the demand and supply of credit in the UK. One of its major findings — at times overlooked by some, given the more prominent coverage of buy-now-pay-later regulation — is a call for the industry to do more to improve availability of credit amongst the UK population. We at L.E.K. Consulting fully subscribe to the Woolard Review's conclusion that more needs to be done to improve credit access. Our work regarding the financially underserved population, who typically have credit history that falls outside mainstream underwriting criteria, reveals that this population is significant in size (16 million to 17 million consumers, or c.30% of all adults, up from c.12 million to 13 million in 2018) with unmet but potential commercially viable credit needs (£2 billion in balance).

In particular, our research finds that these households are facing material economic headwinds, and access to affordable credit is of crucial importance to 1) ensure their near-term economic well-being and 2) ensure that near-term economic conditions do not become entrenched so as to affect the long-term viability of these households as credible borrowers. Unfortunately, our market conversations also reveal that the supply of credit to these households will likely become more challenging in the near-to-medium term, as lenders become more conservative in their lending approach in times of economic uncertainty. In short, a perfect storm is brewing that requires urgent action.

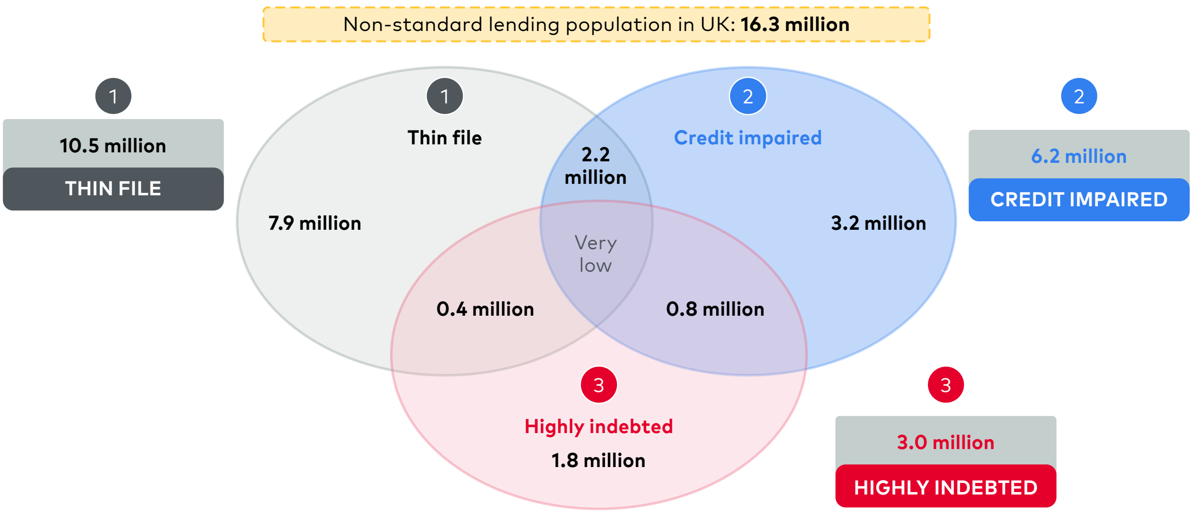
In this article, we summarise our latest research on this population (more conventionally known as the 'non-standard population' in the industry), covering both credit-demand and credit-supply dynamics.

Large non-standard population with growing need for credit

We estimate that the population with non-standard credit needs comprises approximately 16 million to 17 million people, who fall into one or more of three categories (see Figure 1):

1. Thin file: low or no credit history (e.g. recent immigrants to the country or students who have not been able to build up credit); these households have a viable path to establishing a longer credit history
2. Credit impaired: poor credit rating, often linked to (temporary) disruptive life events (e.g. divorce, loss of job, health problems) leading to missed repayments
3. Highly indebted: individuals who have taken on too much debt and cannot afford to repay

Figure 1
Thin file and credit impaired are the largest segments within the non-standard population, although material overlaps exist across the segments



Note: *Overlapping segment is not explicitly quantified, but expected to be very low given it is quite unlikely someone simultaneously fits across all three segments
Source: L.E.K. Non-standard Consumer Survey 2023; ONS; FCA Financial Lives survey 2022; NMG Household Survey (Bank of England); UK CCJ Registry; Insolvency Registry

This population has grown in recent years, especially with the impact of Covid-19 on incomes and working habits (e.g. growth in zero-hours contracts and reduced labour market participation), which has disproportionately affected the non-standard population. The ongoing cost-of-living crisis and rising interest rates have also had an effect.

Another reason for the expansion of this population is supply driven. A desire to be seen as responsible and comprehensive in underwriting in response to regulation has led some lenders to take a more conservative approach and demand longer credit history — resulting in many more households falling into the thin file segment. To be clear, this regulation and the response are well intended, aiming to avoid inappropriate lending that could lead to financial trouble for consumers, but there are also broader unintended consequences in terms of the number of consumers receiving mainstream service.

Based on our consumer survey, we estimate this population has a material credit need of c.£19 billion to £20 billion (in balance). Of this, c.£13 billion is estimated to be met already by existing providers, leaving c.£7 billion of unmet need. It is essential to note that it is not appropriate that all these households should be able to take out further borrowing, both in the sense that it would be detrimental to consumer well-being as well as being commercially unviable for credit providers. In other words, although they would like to have the money, means other than further borrowing are needed to meet the underlying financial need. Accounting for these characteristics, we estimate the current unmet but potentially commercially viable credit need (i.e. the shortage in credit supply) to be c.£2 billion (see Figure 2).

It is also worth noting that in addition to this new borrowing that would lead to higher household indebtedness, there is also need for loan consolidation for the non-standard population who can't afford to take out more debt, but who would benefit from structuring existing borrowing into a small number of loans or a single loan that has lower total monthly payments. Our survey indicates this option (and its benefits) is not often well understood by consumers.

Figure 2

Total demand for credit in non-standard population (2023)

	Total demand		Met demand		Unmet demand	
Severely credit challenged	£9.7bn	−	£4.9bn	=	£4.8bn	Further commercial lending not viable
Other non-standard	£9.9bn	−	£7.9bn	=	£2.0bn	Commercially viable supply gap
Total	c.£20bn		c.£13bn		c.£7bn	

Source: L.E.K. research and analysis

Unsurprisingly, our survey of this population points to credit needs growing rapidly as economic challenges continue to bite, with most households expecting their credit needs to grow by 10% in the next five years.

Insufficient credit availability and access for the non-standard population driving a growing 'credit gap'

A review of lenders serving the non-standard population indicates that supply of credit has grown by c.2% p.a. since 2017, which is materially below the rate of increase of the non-standard population and their credit needs. In particular, the growth in credit supply has masked important mix shifts, where 1) some products (e.g. high-cost short-term credit (HCSTC), home-collected credit, guarantor loans) have all but disappeared and 2) credit growth has been skewed towards some product categories (e.g. motor finance, second charge mortgages), whereas credit to support day-to-day living expenses (e.g. sub-prime credit cards) has essentially been stagnant (see Figure 3). This points to a supply landscape that is not only failing to keep up with demand, but is also not fully meeting the product needs of its customers.

Figure 3

Despite this growth in lending to non-standard borrowers, there is a widening gap as lending lags the growth of the non-standard population and is skewed towards a few products and use cases

	Non-standard population	Outstanding non-standard consumer credit loan balance	Selected product lines: Sub-prime credit cards	Selected product lines: Motor finance
2017	c.12m	c.£10.9bn	c.£4.2bn	c.£0.8bn
2023	c.16m	c.£12.3bn	c.£4.4bn	c.£2.0bn
Delta	c.4m	c.£1.4bn	c.£0.2bn	c.£1.8m
CAGR	**c.6.5%**	**c.2.5%**	**c.1%**	**c.20%**

Growth in car finance dates to post-2014/15 due to the relaxing of supply constraints, rather than increased demand for car finance from the non-standard population

Note: GAGR = Compound Annual Growth Rate
Source: L.E.K. research and analysis; Companies House; annual reports

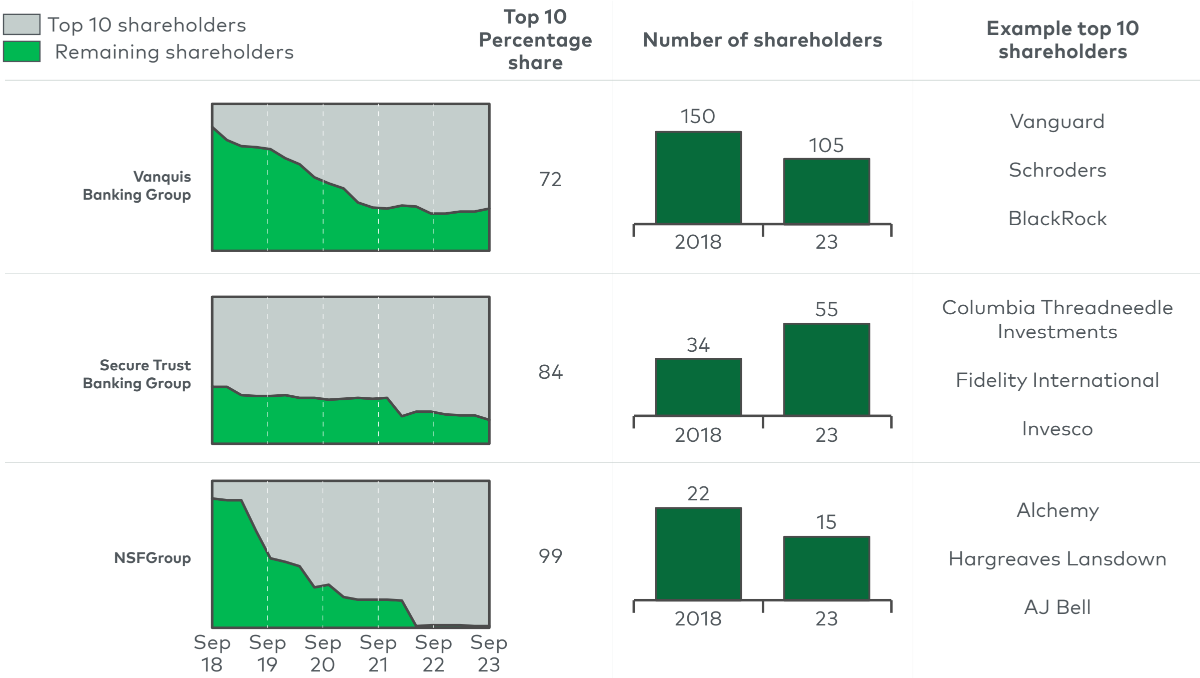
A combination of causes underlies this outcome.

1. There are only a few specialist providers of scale in each of the major product categories targeting the non-standard population, with virtually no mainstream lenders participating. Whilst this is not the original intention of mainstream lenders, the reality is that this population requires more customised underwriting approaches and algorithms to which the efficient but highly standardised automated processes that mainstream lenders have developed for prime borrowers are ill suited. Additionally, the high capital requirements for underwriting non-standard risk, as well as the (naturally and appropriately) heightened associated regulatory scrutiny, have made participation

much more difficult to prioritise for mainstream lenders versus their existing core business lines.

2. Regulatory interventions that have successfully protected some customer groups against damaging financial outcomes have also made some product categories difficult to supply in a commercially viable way (e.g. HCSTC, rent-to-own), resulting in some of these falling away. Insufficient alternative affordable products have emerged to service the underlying credit needs previously addressed by these products.
3. Lenders that continue to be active in offering credit to the non-standard population have been tightening their underwriting criteria (and therefore the amount of credit supplied) in response to the Financial Conduct Authority's increasing scrutiny of the sector — again, effective in protecting some consumer groups while making it more challenging to serve others. This has unfortunately coincided with a period during which consumers' economic situations have been the most challenging (Covid-19, high inflation and high interest rates).
4. Relatedly, we also note that (wholesale debt and equity) investor appetite to fund at least some areas of non-standard lending has also retrenched in recent years, driven by 1) a perception that despite its good intentions in protecting some consumer groups, the regulatory environment has made consumer lending in the non-standard population more difficult relative to other segments (e.g. small and medium enterprises lending); and 2) general cautiousness with regards to economic conditions, in particular risk in the back-book of lending. This is evident even in listed bank lenders where there is increasing concentration in their shareholder registers (see Figure 4).
5. Lastly, many consumers in the non-standard population remain unaware of the credit products available to them, and/or they are unaware of how to access these products (notably from credit unions and community development finance institutions, which provide affordable funding to many who struggle to gain access to credit elsewhere).

Figure 4
Shareholder concentration among listed specialist lenders



Source: LSEG

All in all, market participants and commentators believe the supply of credit will become increasingly challenging (despite the growth in credit needs) as many of the factors that we have identified above continue to play out. In short, we expect the credit gap to continue to expand at a time when credit is most needed.

An urgent call to action

Whilst the current situation is difficult, it is still possible to mitigate its impact through a combination of measures aiming to address different parts of the problem. The table below collates a number of illustrative potential actions on which the industry and the regulator in combination could consider collaborating, where feasible, to improve access (see Figure 5).

Figure 5
Illustrative potential avenues to address undersupply

A Socially focused funding to support greater availability of lending to non-standard population	1	First loss protection
	2	Loan guarantees (partial or complete)
	3	Subsidise rates (APR) for specific segments of the population
	4	Support specific products, notably debt consolidation
	5	British Business Bank–like institution for consumer specialist lending
	6	Education programmes aimed at greater consumer finance awareness
B Advocating for rebalancing elements of current regulatory approach based on assessment of holistic impact	1	Allow for evidence-based flexibility around creditworthiness assessments to facilitate lending within suitable sub-segments of the 'thin file' population
	2	Improve ability to provide debt consolidation products, ensuring that over-indebtedness checks do not prevent access that is counter to holistic consumer interests
	3	Consider impact of FOS fees on product segment viability
	4	Require data pooling by lending institutions to support evidence-based underwriting for non-standard population
	5	Consider calibration of capital regime to support specialist lenders' appetite to work with underserved consumers
	6	Implement central forbearance fund to support specialist lenders (analogous to the Pension Protection Fund)

Source: L.E.K. research and analysis

There is no single silver bullet, but with that collaboration, such initiatives could go some way towards achieving much-needed improvements in credit supply to millions of people.

About the Authors

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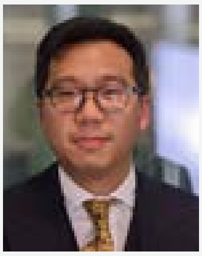
Peter Ward is a Partner in L.E.K.'s London office and a member of L.E.K.'s European Regional Management Committee. Having joined L.E.K. in 2000, his primary focus is on corporate strategy development, complemented by substantial experience in buy- and sell-side commercial due diligence, commercial bid support and litigation support. He also has significant expertise in performance measurement and incentive structures, both within organizations and across contractual boundaries. His work has included secondments to several client organizations, focusing on strategic planning, organization and performance, and implementation.

Peter has deep sector expertise in regulated industries, principally financial services, including advice on regulatory submissions and working with government departments. His main areas of focus in financial services are retail and SME banking, retail and commercial general insurance, specialist (i.e., non-bank) lending and debt management. Peter holds the degree of Master of Mathematics (first class honors) from Oxford University



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Bronswe Cheung, a Partner in L.E.K. Consulting's London office, is a member of the Financial Services practice, with a focus on European wealth management and specialist consumer and business lending. He has significant experience across the wealth management and lending value chains and has worked on strategy development and implementation, due diligence, M&A and synergy valuation engagements across Europe and Asia. Bronswe, who joined L.E.K. in 2011, holds a BSc in economics from the London School of Economics.

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