Grant Thornton

Financial Services Restructuring

Consumer credit in a cost of living crisis

2023

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In this report

The consumer credit sector plays a vital role in helping people, even more so in the current cost of living crisis. But while demand for consumer credit is increasing – and evolving with the growth of Buy Now Pay Later (BNPL) – so too are concerns around default rates. How to reliably assess affordability and identify vulnerability will also continue to be key issues for firms in 2023.

Together with greater regulatory oversight, the risk of retrospective redress claims remains a concern for the sector, with several firms using restructuring tools such as Schemes of Arrangement or Restructuring Plans to crystallise these liabilities.

This report provides an overview of the market environment, together with the challenges and opportunities consumer credit businesses face in 2023. We include a spotlight on the fast growing sectors of BNPL and payments and e-money, as well as details of our market leading credentials in consumer credit.

We will cover:

Delinquency rates

Increasing regulatory oversight

Vulnerability

Working capital challenges

Affordability

Growth of Buy Now Pay Later

Consumer complaints and redress

Spotlight on payments and e-money

Schemes of Arrangement

Questions to consider

Market environment

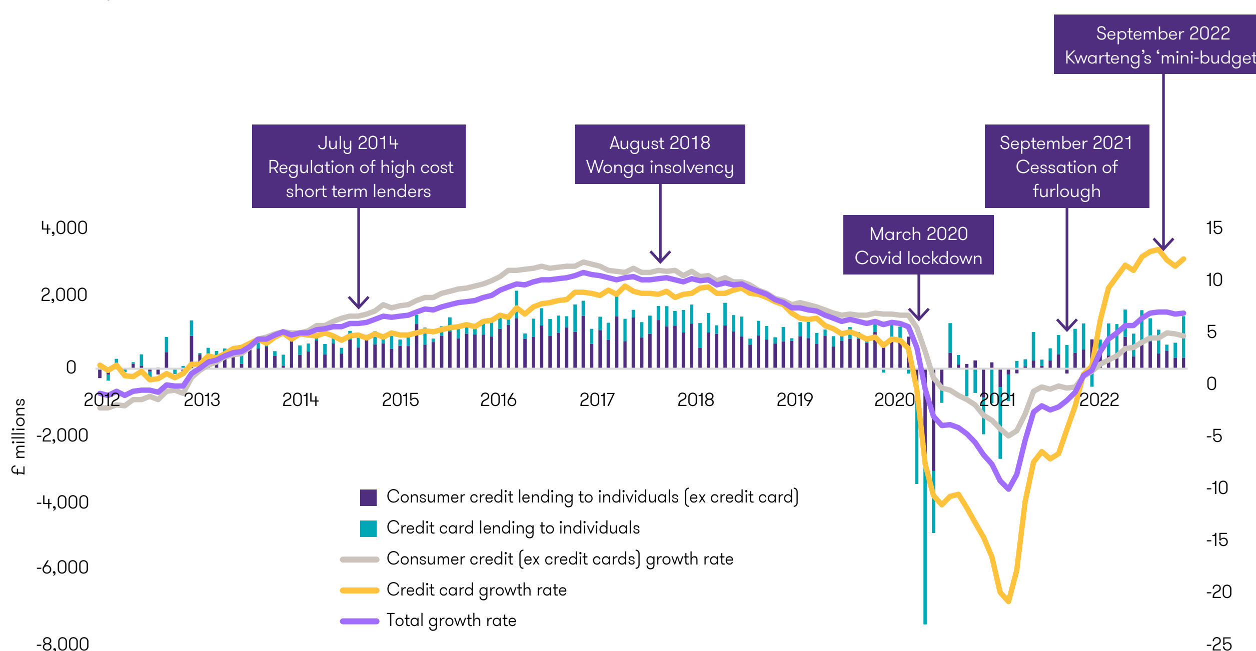
Overview

The cost of living has been increasing across the UK since early 2021, with the annual rate of inflation reaching 11.1% in October 2022, a 41 year high, before falling back to 10.7% in November 2022. This is having a significant impact on demand for consumer credit in the UK.

With household incomes under increasing pressure driven by this period of high inflation and higher interest rates, demand for consumer finance is growing. Latest figures show consumer credit new business increased by 15% in the first 11 months of 2022 compared to the same period in 2021[1]. The average total debt per adult is currently £34,547, nearly 10% higher than 2019[2].

At the same time, the number of consumer credit providers is shrinking. Major players such as Wonga, Quickquid, Perfect Home, Loans at Home, Brighthouse and Safety Net have left the market. Morses Club has scaled back lending, Provident Financial has closed their consumer credit division and Amigo has taken a significant break from undertaking new lending while the firm undergoes restructuring.

The chart below clearly illustrates the effect of the cost of living crisis, showing how much consumer credit households take on, split between credit cards and other forms of consumer credit:



- A positive net flow means households are increasing their consumer credit, whereas a negative flow shows that overall they are repaying credit.
- After a covid related hiatus, consumer lending has recovered.
- Given the cost of living crisis, we expect demand for consumer credit to continue its steep growth rate.

With budgets squeezed by the cost of living crisis, the sector is having to contend with shifts in consumer behaviour, an increase in delinquency rates and growing regulatory oversight.

1 Latest Consumer Finance Statistics – Finance & Leasing Association (fla.org.uk)
2 Statistics Archive – The Money Charity (themoneycharity.org.uk/money-statistics)

Key issues for the sector in 2023

Delinquency rates

The cost of living crisis has led real wages (excluding bonuses) to fall by 2.9%, one of the largest falls seen since comparable records began in 2001. While this has translated to increased demand for consumer credit, it is also expected to contribute to a rise in delinquency rates. The Bank of England's quarterly credit conditions survey shows that default rates on unsecured lending increased in Q4 2022 and that lenders expect them to increase again in Q1 2023, along with more defaults on credit cards and other loans. Consumers in lower income brackets are disproportionately affected by inflationary pressures so the impact on the sub-prime credit sector will potentially be significant, but this will have implications for all businesses in the consumer credit sector.

Vulnerability

Research by the FCA in October 2020 showed that 27.7 million adults had characteristics of vulnerability, a 15% increase on pre-pandemic levels, equating to 53% of all adults. Since then, consumers have seen Covid-related government support withdrawn and been buffeted by the cost of living crisis. Identifying vulnerability remains crucial but harder than ever in such a fast changing economic environment. People's financial situation can deteriorate quickly and consumer credit providers need to ensure their processes capture newly vulnerable customer groups so they remain compliant with regulatory obligations and do not expose themselves to unaffordable or irresponsible lending complaints.

Affordability

The FCA has explicitly stated they do not want consumer credit firms to lower affordability standards in the current climate. Maintaining robust affordability assessments is hard as the financial upheavals faced by many since 2020 coupled with costs rising so fast make a customer's track record of affordability less relevant when looking at future affordability.

A key part of assessing affordability is capturing a consumer's borrowings with other providers. The popularity of buy-now-pay-later (BNPL) makes that increasingly challenging. BNPL firms are not yet regulated and therefore not obliged to share data around user's borrowings with credit reference agencies (CRA).

While some larger BNPL firms are sharing this data, until BNPL is fully regulated – which is not expected until 2024 – and reporting is more consistent across the sector, consumer credit providers may not have a full picture of a consumer's borrowing which can have implications when assessing affordability.

Consumer complaints and redress

Complaints about irresponsible lending and corresponding redress liabilities continue to be a major challenge for the sector, driven by the involvement of complaints management companies. While the number of complaints to the Financial Ombudsman Service (FOS) has fallen from the high levels seen in 2020/21 (in part due to the Schemes of Arrangement proposed by firms in the sector), in 2021/22 the FOS still received over 19,000 new complaints about historic unaffordable lending, showing this remains an important issue across the wider sector.

While the FCA started regulating the sector in 2014, the FOS imposes the stricter consumer protection standards to loans prior to that date, giving rise to potential historical redress liabilities. The impact of a large number of retrospective claims is considerable: redress payments (including an additional 8% statutory interest) or loan balance readjustments need to be made. The cost involved in the claims management process, including system and platform developments and staff training is significant. In addition, a consumer credit firm must pay fees of £750 per complaint referred, regardless of the outcome. These costs can impact a firm's resources and liquidity, and have been a major contributing factor to the demise of firms in the sector, for example Wonga and Loans at Home.

Schemes of Arrangement

The recent utilisation of schemes of arrangement by firms in the consumer credit sector to compromise redress claims has been driven by a desire to crystalise historical redress liabilities. The first of these was successfully implemented by Instant Cash Loans in 2019. In July 2021, Provident Financial had their scheme sanctioned by the High Court. Following an initial unsuccessful attempt in 2021, Amigo had its 'New Business Scheme' sanctioned by the Court in May 2022. Most recently, Morses Club proposed their scheme in December 2022.

Although a costly process, a scheme can provide finality for a firm in respect of their redress liabilities, and can improve consumer outcomes when compared to an insolvency. Once legacy redress issues have been eradicated, future debt or equity raises become much more attractive to potential investors.

The outcomes of the above mentioned schemes are precedent setting for the sector. The judgements in each case are instructive for how consumer credit firms, and their lenders should approach the use of schemes.

Key lessons learned show that early engagement with the FCA is vital to minimise the risk of the regulator opposing the scheme (as happened with Amigo's 2021 scheme). Safeguarding and representing the interests of consumer creditors will be an important feature of redress schemes in the future. Identifying and evaluating the 'relevant alternative' is important, with a firm needing to demonstrate that the proposed scheme offers a better return than the alternative. Parallel alternative schemes may also be a useful strategy where there is a risk that the preferred scheme will not be sanctioned and where having to start the process over again would not benefit creditors.

Increasing regulatory oversight

The consumer credit sector remains in the regulatory spotlight.

In May 2022, the FCA issued a 'Dear CEO' letter outlining concern that firms in the sector may 'exploit the cost of living crisis to promote their services, and that increased demand may result in unsustainable and often unaffordable lending'. The regulator has used similar letters to remind firms of their obligations, particularly around treating customers fairly and regulatory expectations towards vulnerable customers.

Operational resilience – rules around strengthening firms operational resilience came into effect 31 March 2022. All financial services firms must be able to show they can remain within their impact tolerances for each important business service by 31 March 2025.

Consumer duty – the final rules for this major piece of legislation were published in July 2022. Management need to consider every step of the customer journey to assess any areas which may give rise to customer harm. The Duty is intended to represent a paradigm shift in how the FCA regulates the retail sector, part of the move to an outcomes based approach. Firms have until 31 July 2023 to implement the rules for new and existing products or services – and it will take significant time and resources to comply.

Wind down plans – the FCA requires all financial services firms to have a comprehensive wind down plan (WDP) in place to manage liquidity and resolution risks in the event the firm fails. The regulator has been proactive in reviewing and assessing WDPs and has been critical of the quality of plans already in existence. Firms need to ensure they have a WDP in place that meets regulatory expectations, and this should be an area of focus in 2023.

Working capital challenges

Given the macroeconomic headwinds, consumer credit firms are likely to experience an increase in requests for forbearance, as well as rising default rates. Liquidity for such lenders must be tightly managed in these circumstances, to forestall potential working capital issues.

Where firms rely on repeat lending, the knock on effect of higher default rates can be magnified. Management need to consider whether increased delinquencies will impact a firm's own funding arrangements, including compliance with covenants.

At a corporate level, many consumer credit firms have taken on more debt to meet liquidity concerns and deal with increased operational costs. Higher interest rates will also be putting more pressure on cashflow.

Granular cash flow forecasting should be undertaken on a weekly basis to ascertain whether firms have enough liquidity to get them through the next 12-24 months, and management needs to plan for any debt facilities due to mature in the short to medium term.

Growth of Buy Now Pay Later

The Buy Now Pay Later (BNPL) sector is a large and growing market, expected to grow approximately 25% a year between 2022-2028 against a backdrop of the sharp increase in the cost of living. According to a Bain & Company survey, BNPL is a key part of 75% of retailers growth plan. The existing market leaders are backed by large multi-nationals and the UK market is a key target area for expansion.

The sector has garnered much media attention. Following the Woolard Review in 2021 and subsequent FCA consultation in 2022, BNPL is due to come within the regulatory perimeter. While the final rules and timing of regulation are still unclear, the FCA has proposed that current rules on creditworthiness assessments should be applied to BNPL agreements, rules on how BNPL firms treat customers in financial difficulty should be introduced, and customer complaints should be referred to the Financial Ombudsman Service (FOS).

Recognising that many BNPL firms have already started this process, the sector will still need to navigate significant change – implementing affordability assessments and processes to identify vulnerability, including tailoring the customer journey appropriately. Firms will also need to develop workable solutions with credit reference agencies, allowing a consumer's BNPL debt to be viewed by other credit providers as part of their affordability assessments. The sector will also be vulnerable to the impact of redress claims, including the risk of retrospective redress claims.

Spotlight on payments and e-money

The payments and e-money sector is fast moving and has experienced high growth in recent years. However, a number of high profile failures has served to highlight sectoral risks. For example, following the failure of five payments and e-money firms between October 2018 and March 2020, the FCA identified a £40 million shortfall in funds owed to customers.

Research by the FCA in 2021 showed the sector had one of the lowest levels of financial resilience within solo-regulated firms. Since then, the sector has faced headwinds as reduced consumer spend has led to depressed transaction value, with rising delinquencies. As such, it has become a regulatory priority for the FCA.

New annual safeguarding audit requirements, a continued focus improving the quality of the sectors' wind down plans and a new Special Administration Regime for payments and e-money firms (pSAR) all form part of the regulatory approach designed to build confidence in the sector.

Questions to consider

We consider the questions below as some of the more important areas for consumer credit firms to focus on – some will be more relevant to your business than others.

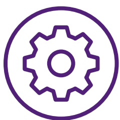
Assess	Protect	Restore

Regulatory compliance

- Are affordability and vulnerability assessments fit for purpose in the current fast moving macro-economic environment?
- Does the firm's lending criteria need to be revisited?
- Are all statutory notices issued as required to ensure there are no issues when seeking to recover non-performing loans?
- Has the firm met and documented all operational resilience requirements, and will it be ready to show it can remain within impact tolerances by March 2025?
- Is the firm on track for embedding the new Consumer Duty requirements?
- Does the firm have a robust wind down plan, and does this need to be revisited in light of changes in the macro-economic environment?

Liquidity and refinancing

- How will increased levels of consumer delinquency impact liquidity?
- Are appropriate forecasting models in place to stress test resilience in different scenarios and identify triggers that might lead to underperformance?
- What sources of short-term finance/funding are available, and will these be on significantly tighter terms and higher interest rates than before?
- Is the firm able to remain within its financial covenants, and what are the options to restructure debt obligations?
- Can management demonstrate the viability of the business, and how is this best positioned with stakeholders?



Operational improvement

- Is the firm leveraging customer data to best effect?
- Should the firm invest in talent acquisition or form new partnerships to utilise data analytics?
- Where automated decision making is used for credit decisions, does the data behind the algorithms used need to be updated or reviewed?

Taking advantage of opportunities

- With some high profile collapses in the sector, many consumers need to relocate to a new lender – how can the firm take advantage of this?
- Given the growing precedent of using restructuring tools to crystallise liabilities, is this something the firm should consider?
- How can the firm tap into increased demand for consumer credit, while still meeting FCA expectations?

Our solutions

Wind-down planning

Supporting firms to cease regulated activities with minimal adverse impact on its clients and counterparties. This includes scenarios where a firm may wish to undertake a strategic exit, as well as an unexpected crisis or insolvency.

Restructuring procedures

Negotiating restructuring procedures such as Schemes of Arrangement and Restructuring Plans, handling the process from beginning to end and managing competing priorities of stakeholders.

Contingency planning

Advising on the options available to stakeholders in the event of a crisis or financial distress, including assessment of outcomes in various scenarios.

Debt advisory and refinancing

Sourcing new or alternative funding (including ABLs), negotiating with existing funders, restructuring of debt and equity to provide financial stability.

Back up service facilitator

Co-ordinating the implementation of a wind-down on the occurrence of certain trigger events.

Solvent eliminations

Used to extract assets and cash from a solvent company in a tax-efficient way.

Cash flow forecasts

Review of short term or medium term cash flow forecasts to assess funding requirements, as well as ongoing cash flow monitoring.

Independent business and pre-lending reviews

An independent assessment of the financial health and viability of a business, with a view to protecting lenders' exposure.

Turnaround services

Providing support to create financial stability, advising on NPL portfolios, assessing cash flow, and identifying other means of improving short term liquidity or addressing drivers of underperformance.

AMA processes

An accelerated sales process, used to realise value for key stakeholders.

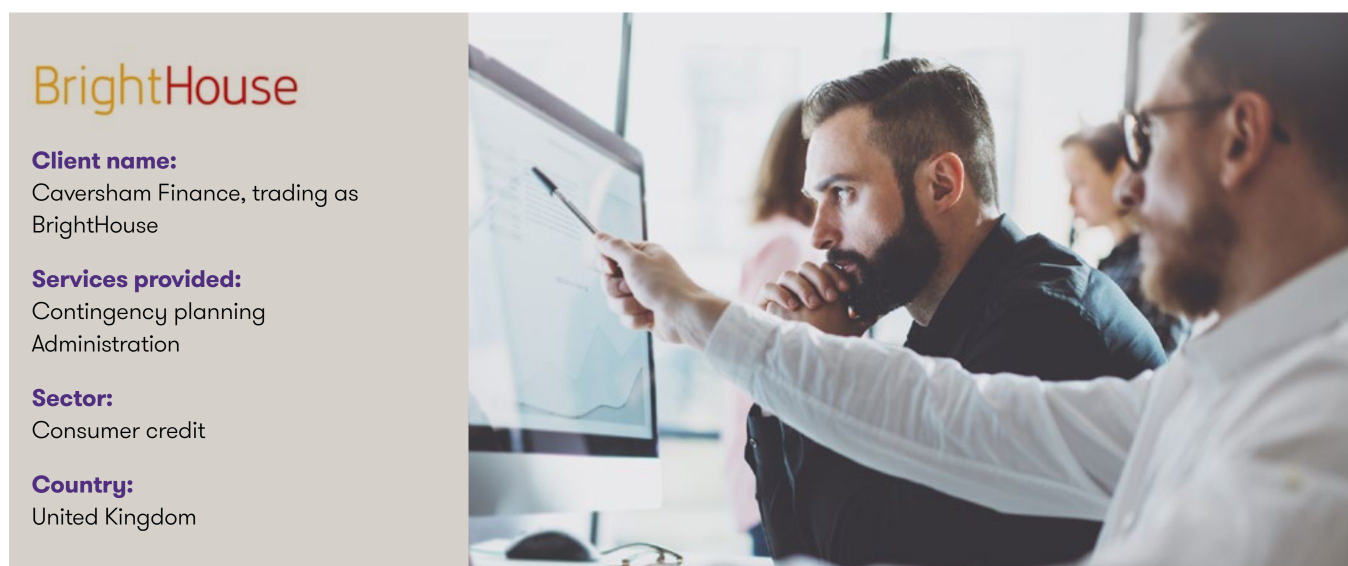
Corporate insolvency appointments

Statutory insolvency appointments, including administrations, liquidation, receiverships, CVLs.

Credentials

In this section, we share examples of our credentials in the consumer credit sector.

The wind down of Caversham Finance, trading as BrightHouse



Brighthouse was a consumer credit provider with an outstanding loan book of c.£230 million with 165,000 active customers.

Background

Large volumes of affordability claims from customers put severe stress on the Group's cashflow and led to increased concern from lenders and creditors.

Pressure was exacerbated by the pandemic which had a significant negative impact on revenues and cash collections and led to the closure of all stores on 25 March 2020.

Prior to Administration the group employed c.1,700 employees, operating from c.250 retail store locations nationwide.

Our role

We were appointed administrators of the Company. Initially, Brighthouse engaged us to assist the Board with regular board meetings and outlined strategic options analysis to provide practical support to allow the group to continue to trade.

During the course of this work our scope expanded to include contingency planning for a possible insolvency.

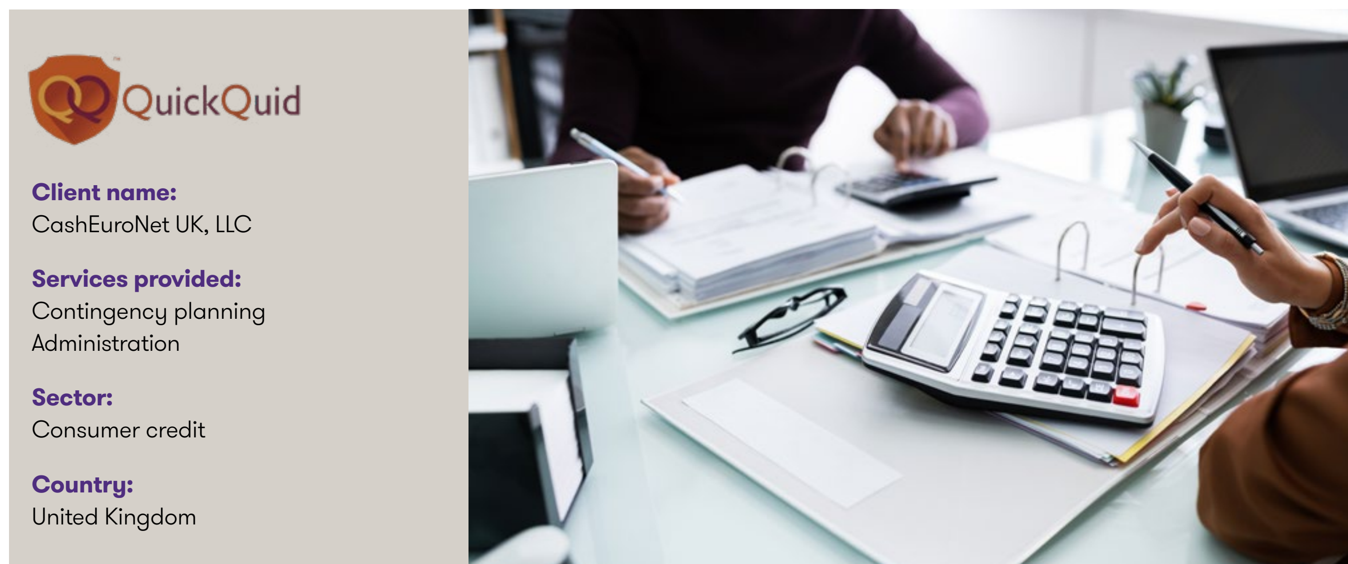
Our work also included insolvency outcome planning to illustrate a return to the secured creditors in an insolvency at an entity level.

Outcome

Due to the continued level of redress claims, adverse PR and the impact of COVID-19, the two trading entities were placed into Administration.

Working closely with the FCA, the Joint Administrators from Grant Thornton maintained trading in order to maximise collections activities. Trading subsequently ceased in December 2022 and the operations were wound down.

The wind down of CashEuroNet UK, LLC, trading as QuickQuid



CashEuroNet UK, LLC was a consumer credit provider with an outstanding loan book of c.£300 million with 1.9 million total customers. Trading names included QuickQuid, Pounds to Pocket and On Stride Financial.

Background

The Company was heavily reliant on funding from its parent, Enova International, Inc, especially as a result of the redress complaints made against the Company.

Following refusal by the FCA to support its proposed scheme of arrangement, there was a threat to the medium-term viability of the Company and increasing cash flow pressures.

In addition, management was concerned that Enova International Inc would withdraw its support.

Our role

We were appointed Administrators of the Company. We worked with the management team to prepare a contingency plan in the event that the parent withdrew its support. This included support to the Board in its consideration of "reasonable prospects of avoiding an insolvency".

In addition, we also reviewed the Company's short-term cash flow and operating cost rationalisation proposals. Our work also included planning for an insolvent outcome including the illustrative return to the creditors in an insolvency at an entity level.

Outcome

Following the Parent's withdrawal of financial support and the heavy burden of the redress claims, partners of Grant Thornton were appointed as Joint Administrators of the Company, working closely with the FCA.

During the administration collections activities were maintained in order to maximise the value of the loan book. Additionally, a redress tool and adjudication process was built and implemented, after which a full customer redress programme was conducted resulting in £150 million of claims.

The wind down of Wonga Group Limited and subsidiaries

Client name:
Wonga Group Ltd and subsidiaries

Services provided:
Contingency planning
Administration

Sector:
Consumer credit

Country:
United Kingdom

Wonga was previously the largest provider of high cost short term credit in the UK and had invested in a number of complementary overseas businesses.

Background

Following regulatory oversight as a result of historical poor lending practices and a surge in redress claims, Wonga engaged us to provide contingency planning advice whilst the management team investigated strategic options. We were subsequently appointed Administrators to manage the winddown and distributions to creditors.

Wonga's outstanding loan book upon appointment represented c.206,000 customers (c.£77 million), together with overseas businesses, including Poland, South Africa and Spain.

Our role

As Administrators, we successfully preserved Wonga's IT lending platform, its infrastructure and customer data to support the winddown and realisation strategies, allowing Wonga's overseas subsidiaries to initially continue trading with limited disruption.

We developed an online claims portal and automated assessment process for customer redress claims, which given the volume of potential creditors meant considerable cost savings to ensure funds available for distribution.

We worked closely with the FCA to discuss both the practical and legal interaction of the Insolvency Act and FCA dispute resolution rules and reconciled areas of conflict between the two, with the avoidance of protracted Court litigation.

We realised the UK current loan book (c.£20 million) allowing the secured creditor to be repaid in full and sold the overseas trading subsidiaries via the solvent wind-down of Wonga Spain, and sales of Wonga Poland and Wonga South Africa. We fully migrated the platform's technical services and data to the purchasers in accordance with GDPR.

Outcome

We successfully maintained collections activities allowing the secured creditor to be repaid in full and also maximised value from the overseas trading subsidiaries via sales processes (Wonga Poland) and solvent wind down (Wonga Spain and Wonga South Africa).

We won the Creditor Engagement Award at the TRI Awards 2019 for our multi-pronged approach which ensured coverage, clarity and consistency to all customers, totalling more than two million individuals.

The wind down of SD Taylor Limited, trading as Loans at Home

Client name:
SD Taylor Limited

Services provided:
Contingency planning
Administration

Sector:
Consumer credit

Country:
United Kingdom

Loans at Home was a supplier of home credit, providing loans of £100 to £1,000 per loan, typically for between 14-18 weeks. The outstanding loan portfolio was c. £57.9 million, with c.72,000 customers.

Background

Profitability of Loans at Home declined in 2020 by 28%, and further declined by 2021 by 13%. At this time, and following engagement with the FCA, the directors concluded that future trading was no longer viable.

Large volumes of affordability claims from customers put severe pressure on the company's cashflow and increased lender and creditor pressure.

Due to the continued level of redress claims and the impact of COVID-19, the company was placed into Administration in March 2022. At the time of appointment, there were 279 employees and 697 self employed agents working from 60 branches across England, Wales and Scotland.

Given the vulnerable nature of the customer base, as part of our contingency planning we developed a strategy with key staff to ensure that the collect out strategy was customer centric and followed all FCA guidelines.

Our role

Loans at Home engaged us to assist in providing contingency planning support in respect of an orderly winddown and collect out of the loan book via an administration process, including estimated return to creditors.

Partners at Grant Thornton were subsequently appointed administrators of the Company.

Outcome

The administration of Loans at Home remains ongoing albeit collections activities have ceased. The Administrators are currently ensuring the company's operations are wound down in an orderly and secure manner.

Recent Financial Services Restructuring engagements

Greensill Capital

Supply chain finance

Continency planning and subsequent Administration appointment

Recovery of c.$17 billion of receivables on behalf of GCUK and its investors

Cyrus Co-Op Bank

Bank

Advisory role

Advising bank and Republic of Cyrus on the transfer of certain assets and liabilities of Cyprus Cooperative Bank's to Hellenic Bank

Lendy Ltd

Peer to PeerProperty Finance Platform

Conflict administrators

Acting as conflict administrators in respect of certain issues arising on this high-profile P2P lender

Project Bloom

Consumer credit

Restructuring advisory

Outstanding loan book of >£200 million

Project Paddington

Banking

Solvent reorganisation and windown

Restructuring advisory services

Project Falcon

Wealth management

Solvent winddown support

Restructuring advisory services

Project Bernard

Consumer credit

Restructuring advisory

Delivering a solution to address increasing redress exposure in a way that avoids a formal insolvency

Project Skate

Transport rental business

Back up servicing

BUS agreement, as part of company's growth plan

Project Snowden

Insurance carrier and intermediary

IBR and Board observer role

Advising the lender on recovery plans and ongoing monitoring

Project Juniper

Consumer credit

Insolvency outcome analysis

Contingency planning and estimated outcome insolvency analysis

MMP Financial Ltd

Consumer credit

Solvent winddown support

Repayment demand relating to inter-company loan impacted ability to trade solvently

Barclays plc

Large UK systematic bank

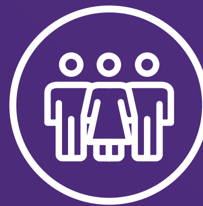
Skilled person review – ring fencing of retail operations

Restructuring advisory services

Grant Thornton's delivery for Financial Services clients

85%

We advise 85% of the top 20 global banks and work with six of the 10 largest global insurance firms



300+

experts within the firm's Financial Services Group, consisting of over 30 partners and 300 restructuring employees

£3b

of asset recovery globally over the previous nine years

£570m

Globally, our financial services offering is a practice of more than £570m

£1b

We have assisted financial services clients to recover over £1 billion of 'lost causes', turning write-offs into recovery

9/10

We are one of the largest providers of Skilled Person Reviews to the FCA, sitting on nine of the 10 FCA Skilled Person Panels

Contact us

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