

# What do we know about unregulated or informal forms of credit?

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COVID-19 has worsened inequality in the UK's credit landscape, with certain groups at higher risk of over-reliance on credit, such as women, people with mental health problems, and some ethnic minorities. The review examines the rise of buy-now-pay-later, illegal money lending, and informal borrowing, highlighting the need to support people in making informed choices about credit. Buy-now-pay-later users are at risk of problem debt, while illegal money lending and informal borrowing from family and friends can lead to a number of negative outcomes.

### Context:

Credit is part of many people's lives in the UK and, for almost 1 in 5 (17%), used to purchase essentials. The impact of COVID-19 has exacerbated previous trends of inequality regarding over-reliance on credit, and recent shifts in the credit market (such as the rise of payday lenders and unregulated products, e.g. Buy Now Pay Later or BNPL) are changing the credit landscape.

Evidence shows that certain people are more likely to be affected by this change, for example: those more likely to use BNPL products, such as young people; and certain groups who are more at risk of becoming over-reliant on credit such as women, people with mental health problems, single parents, and some ethnic minorities.<sup>1</sup> These groups are therefore even more likely to experience the negative outcomes associated with these types of credit, that are highlighted below.

This review looks at: 1) Buy Now Pay Later; 2) illegal money lending; and 3) informal lending.

### Buy Now Pay Later (BNPL)

More and more individuals are using Buy Now Pay Later as a method of credit, and this number is growing rapidly.<sup>2</sup> While BNPL can be an important credit tool for many people, there is concern that an increasing number of users are at risk of becoming over-reliant on credit,<sup>3</sup> and data from the Money and Pensions Service (MaPS) shows that many users are already in problem debt or on the brink of it.<sup>4</sup> Many debt advisers note that their clients do not view BNPL as a form of credit, as an interest free product could be considered sharia compliant for example.<sup>5</sup>

In a recent consultation, the government confirmed its intention to subject BNPL to further scrutiny and regulation.<sup>6</sup> MaPS has highlighted four areas of concern with the way BNPL is set up: its light-touch credit and affordability checks; customers' lack of understanding of the product; credit score invisibility (as creditors find it difficult to capture a person's full credit profile as BNPL often doesn't show up); and the use of BNPL for food and essentials.<sup>7</sup>

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<sup>1</sup> Coventry University and The Money and Pensions Service, 'Helping those who use credit to make ends meet' July 2022 <https://www.fincap.org.uk/en/reviews/helping-those-who-use-credit-to-make-ends-meet>

<sup>2</sup> Coventry University and MaPS page 20.

<sup>3</sup> Coventry University and MaPS page 4.

<sup>4</sup> The Money and Pensions Service, 'Buy Now Pay Later – the customers and MaPS' Concerns' June 2022 <https://moneyandpensionsservice.org.uk/2022/06/21/buy-now-pay-later-the-customers-and-maps-concerns/>

<sup>5</sup> HM Treasury, 'Regulation of Buy-Now-Pay-Later: Response to consultation' June 2022, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1083547/BNPL\\_consultation\\_response\\_\\_Formatted\\_.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1083547/BNPL_consultation_response__Formatted_.pdf)

<sup>6</sup> HM Treasury, 'Regulation of Buy-Now-Pay-Later: Response to consultation' June 2022, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1083547/BNPL\\_consultation\\_response\\_\\_Formatted\\_.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1083547/BNPL_consultation_response__Formatted_.pdf)

<sup>7</sup> The Money and Pensions Service, 'Buy Now Pay Later – the customers and MaPS' Concerns' June 2022 <https://moneyandpensionsservice.org.uk/2022/06/21/buy-now-pay-later-the-customers-and-maps-concerns/>

The FCA has taken steps in driving change in the BNPL sector. For example, by working with four large firms (Clearpay, Klarna, Laybuy and Openpay) to implement changes such as making consumer contracts fairer, easier to understand and more transparent.<sup>8</sup>

## Illegal money lending

The number of people borrowing from illegal money lenders (often known as 'loan sharks') is on the rise, with current estimates ranging from several hundred thousand to over 1 million adults, an increase of over 700,000 more than the recent official estimate in 2010.<sup>9</sup> Borrowing in this way is usually a last resort, after attempts to borrow through legitimate sources, including high-cost options, have failed.<sup>10</sup>

Those who resort to borrowing from illegal money lenders are typically on lower-incomes, already in debt, live in social housing, and have long-term health conditions.<sup>11</sup> This type of borrowing can have dire consequences, such as high repayment costs that lead to further indebtedness, threats and violence, payment in kind (such as delivering drugs or providing other favours), family and relationship breakdowns, despair and even suicide.<sup>12</sup>

Some of these consequences can last for many years. Social media has exacerbated these issues as it means victims can be harassed and humiliated 24 hours a day, and to a wider community than before.<sup>13</sup>

## Informal lending

During times of need, people often turn to their family, friends, and communities for financial support. A survey conducted in late 2021 found that 10% of UK adults had borrowed money from family or friends during the COVID-19 pandemic.<sup>14</sup> For many, this type of informal borrowing is part of a 'mixed economy of credit' that includes both formal and informal credit sources<sup>15</sup> and, like illegal money lending, tends to be a last resort.<sup>16</sup>

However, borrowing from loved ones can come with its own set of challenges. It can cause stress, guilt,<sup>17</sup> and anxiety for the borrower and can place a burden on the lender.<sup>18</sup> This type of informal borrowing is more common among those who have been declined credit,<sup>19</sup> as well as renters, young people, and part-time workers.<sup>20</sup>

## What next?

Did you find this review helpful? We would like to know what you think. Please contact us at [whatworks@fincap.org.uk](mailto:whatworks@fincap.org.uk) with your feedback, and any suggestions for further research or evaluation that should be included in future updates.

## Acknowledgements

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<sup>8</sup> FCA, 'FCA drives changes to Buy Now, Pay Later (BNPL) firms', February 2022 <https://www.fca.org.uk/news/statements/fca-drives-changes-buy-now-pay-later-bnpl-firms-contract-terms>

<sup>9</sup> Coventry University and MaPS page 36.

<sup>10</sup> Coventry University and MaPS page 33.

<sup>11</sup> Coventry University and MaPS page 36.

<sup>12</sup> Coventry University and MaPS page 27.

<sup>13</sup> Coventry University and MaPS page 36-37.

<sup>14</sup> Coventry University and MaPS page 13.

<sup>15</sup> Coventry University and MaPS page 33.

<sup>16</sup> Coventry University and MaPS page 33.

<sup>17</sup> Coventry University and MaPS page 33.

<sup>18</sup> Coventry University and MaPS page 33.

<sup>19</sup> Coventry University and MaPS page 27.

<sup>20</sup> Coventry University and MaPS page 36.

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