



**Consumer
Focus**
Campaigning for a fair deal

Consumer Focus response to the Office of Fair Trading Review of high-cost credit: Interim research report

January 2010

About Consumer Focus

Consumer Focus is the new statutory organisation campaigning for a fair deal for consumers in England, Wales, Scotland, and, for postal services, in Northern Ireland. We will be the voice of the consumer, and work to secure a fair deal on their behalf. We were created through the merger of three consumer organisations – Energywatch, Postwatch and the National Consumer Council (including the Welsh and Scottish Consumer Councils). The new approach allows for more joined-up consumer advocacy, with a single organisation speaking with a powerful voice and able to more readily bring cross-sector expertise to issues of concern.

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Introduction

Consumer Focus very much welcomes the research being conducted in this area by the OFT, as it represents a valuable addition to a limited body of knowledge about consumer behaviour and high cost credit.

Description of credit products

We would make two comments on the descriptions of high cost credit products:

'Specialist loans'

Calling high-cost credit of APRs above 50 per cent 'specialist' loans may be misleading to consumers, for whom the term 'specialist' is likely to have largely positive connotations.

Short-term loans

Payday loans are generally promoted on the basis that they are short-term loans, but the reality for many consumers is that they are renewed on a 'rollover' basis from month to month. When used in the way that they were originally conceived, as short-term loans to smooth the way until payday, they may be a convenient form of lending for some (as described by the PFRC). However, the evidence from the US, supported by the findings of the OFT's research for this review, is that for a significant number of individuals they are used as a form of long-term borrowing. This means the cost of this form of credit to the consumer becomes very high¹. In addition, the way in which these debts are repaid mean that they take on a high priority for consumers, which may mean that only limited funds are left available to pay for priority debts for housing and utility bills. There is considerable potential for loans of this nature to result in financial problems for consumers.

¹ Ernst, Farris and King, Quantifying the Economic Cost of Predatory Payday Lending (2003, revised 2004)

The Social Fund

The Social Fund could be an important source of borrowing for low income consumers, but currently the problems of restrictions on eligibility and scope, the complexity of the applications process, a high rate of refusal and limitations on funding have hampered the degree to which it can perform as an alternative to high cost credit. As we stated in our previous submission to this review, there would need to be considerable changes to the Social Fund for it to meet the level of demand of low cost credit for low income consumers.

Consumer Survey

The consumer survey undertaken in relation to this review is a valuable new piece of evidence in this area, targeting as it does those consumers who use forms of high-cost credit. The difficulty in reaching these consumers is evident from the large sample that was required to find 300 respondents who were users of this kind of credit. While the numbers using this type of credit may be low as a percentage of the population, it is evident that there are still significant numbers of people who rely on these forms of credit. This supports the view that, as many of those who use high cost credit will come from the most vulnerable groups in our society, it is important that it is opened up to careful scrutiny.

We note that the once the sample is broken down into categories of high cost credit, they reduce to below 100 and therefore a degree of caution should be exercised in terms of making any findings on this basis. Nonetheless, these results on a product-by-product basis are indicative of issues of real concern and in need of further in-depth consideration.

The borrowing attitudes and behaviours of those who used high cost credit tend to support previous findings about the difficulties in introducing competitiveness to this market. The importance of speed of arrangement to consumers in this market supports the view that these are people largely operating under considerable financial pressures, with immediate credit needs and with only limited options available to meet those needs. The lack of time taken to reach a decision about taking out credit also indicates this. Concern about the pressures to resort to this type of credit is increased by the levels of dependency on this credit shown by the research, particularly in relation to home collected credit. Consumers are using this form of credit to manage on a day-to-day basis.

As speed is such an important factor for many of those seeking these forms of credit, the procedures and delays associated with conventional credit present a barrier to those who need a swift resolution to their debt problems. Improvements in technology should mean that such delays are no longer necessary and can be eliminated. Further, if there were greater transparency in relation to the criteria for mainstream loans or if there were set loan criteria, low income consumers would be in a better position to assess quickly whether they would be eligible for credit from mainstream providers.

The particular importance of affordable monthly payments to users of this form of credit is a clear indication that these consumers are more concerned with how much they repay each month than the amount they will pay for the credit over the length of the loan even though the total cost of other types of loan could be lower. The consumers' failure to consider the total cost of credit rather than their monthly payments will be compounded by the research finding that a significant number of these consumers do not look into the available options or consider information or advice prior to entering into credit agreements. The fact that most people felt that they had found either the best deal for

them or a good deal for them, despite many having taken their decision very quickly and with only limited information, is indicative of the restrictions on the forms of credit available to this group. It also demonstrates the inherent barriers in getting these consumers to shop around for products.

High-cost credit is often used for small amounts of money. In mainstream financial services, these types of borrowing are often catered for by overdraft facilities on current accounts. A number of borrowers using high-cost credit may be unbanked or have basic bank accounts which do not provide these facilities. Where they do have overdraft facilities, they are often wary of using them because of the high fees and interest rates associated with becoming overdrawn. Recent research conducted by Consumer Focus showed that while many low income consumers did not consider an overdraft an essential part of a bank account (possibly as a result of previous experiences with charges), a significant proportion would be interested in a bank account that had a small interest-free 'buffer zone' (overdraft facility)².

The Competition Commission enquiry into home credit referred to the difficulties in increasing competition in a market where consumers were not price sensitive. We are already aware of the positive elements of home credit for low income consumers, such as the convenience of home collection, lack of complicated application forms, limited risk of refusal, the ability to borrow small amounts of money and pay back in weekly instalments, and no financial penalties for missed payments. Such benefits are likely to inhibit these consumers from finding alternative sources of credit. We question the conclusion in paragraph 5.124 that improving the provision of information and the operation of competition would be the appropriate response to the issue of high-cost credit. The research findings seem to imply this will not provide much of a solution to the problems of high-cost credit for vulnerable consumers.

The impact of the credit crunch and recession

We note the lack of statistical data in relation to high cost credit products. Given the rapid expansion of this sector and increasing concern about these forms of lending, we believe that there is a strong case for measures to be put in place immediately for the collection of robust statistical data on these financial products in the same way as mainstream financial products and would urge the OFT to seek this.

In relation to low income consumers, we would like to make a point with regard to the assessment of 'risk'. Due to being on a low income, consumers in this category are often categorised as 'high risk', on the basis that, as a group, people on low incomes are assessed as more likely to default on loans. However, many low income consumers are careful money managers and responsible borrowers, with whom the risk of default is low. It is important that low income consumers should be assessed individually on the basis of their ability to repay the loan in question (with regard to their overall financial situation).

It is of considerable concern that demand for some high cost credit products has increased in the recession, while at the same time the majority of consumers are reducing their overall indebtedness and mainstream lenders have found that demand for unsecured lending has decreased. The rise in payday lending outlets may indicate that a proportion of these are employed consumers who are no longer able to access mainstream credit, due to increased restrictions on lending. High cost lenders reported that they were receiving loan applications from consumers who would previously have

² Consumer Focus, Opportunity Knocks: Providing alternative banking solutions for low-income consumers at the Post Office (January 2010)

been eligible for mainstream credit. It also is possible that these consumers need additional credit to finance past over-borrowing when credit was much easier to obtain. Clearly certain low income consumers are not in a position to reduce their borrowing. They are reliant on high-cost credit to manage their day-to-day spending and therefore are subject to paying the highest cost for credit from already limited incomes.

International comparisons

It is useful to see the comparisons with other jurisdictions in relation to consumer credit regulation and interest rate ceilings. These comparisons demonstrate the complexity of the issues and the potential difficulty in finding solutions that provide an answer to all the problems presented by high cost credit. However it is important to be aware of the different regulatory regimes and national contexts when making any comparisons and the limitations this brings. For example, illegal lending in Germany means any lending that is not done by a bank, as only banks can provide credit³. The regulatory situation in the UK is somewhat different. Another example of a regulatory difference, which must have an impact on the credit market of the country in question, is that, in France, banks are under an obligation to provide bank accounts to everyone and to give overdraft facilities of 50 per cent of a customer's income on current accounts (with certain limited exceptions eg bankruptcy)⁴.

It seems that the more relaxed regulatory regime in the UK has led to more high cost credit products being available for low income consumers than in the other countries in the study, but the range of products does not appear to have had a positive effect on price competitiveness. In this instance, innovation does not appear to be benefiting low income consumers. The recent innovation of payday lending, for example, is a form of high cost credit with APRs that are sometimes over 1,000 per cent.

We consider that increased information provision and further incentives to innovate are unlikely to bring down prices and address concerns in relation to the high level of interest being charged to those in society with the least financial resources. As stated above, there is little evidence of innovation to the financial benefit of consumers by commercial providers in this market and many consumers already find financial products 'complex and confusing' (61 per cent of those using 'specialist' financial products, as defined by this study). The research findings about consumer behaviour and attitudes in this market tend to contradict that measures of this nature will lead to competition driven as a result of active consumer demand.

Interest rate caps

We stated in our earlier submission to the review that until, there were viable low cost credit alternatives available, interest rate caps should not be considered. The recent report issued by the New Economics Foundation⁵ considered the issue of interest rate caps and international comparisons, highlighting the difficulty of comparing credit markets in different countries. Interest rate caps may not be the answer to all of the problems posed by these forms of credit. It is for example important mainstream lenders should assess low income consumers individually on the basis of their ability to repay the loan in

³ New Economics Foundation, Doorstep Robbery: why the UK needs a fair lending law (November 2009)

⁴ As above

⁵ As above

question (with regard to their overall financial situation) without simply assuming low income equals inability to repay. Nonetheless, our concerns about consumer detriment in this area mean that we believe that interest rate ceilings and their potential impact is an issue the OFT should research in more depth.

The proper assessment of affordability may present an opportunity to reduce the level of potential detriment to consumers. It may be that more targeted solutions are needed on a product-by-product basis. However we do not feel that simply providing more information and attempting to make this market more competitive by encouraging new entrants will be sufficient to meet the concerns about the negative consequences of high cost credit on low income consumers. The experiences of other countries give us an excellent opportunity to learn and develop effective policies that may go some way to addressing the problems faced by those who have to resort to high cost credit in order to cope financially.

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Written by: Marie Burton, Consumer Focus

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From a telephone, call 18002 020 7799 7900

Consumer Focus

4th Floor
Artillery House
Artillery Row
London SW1P 1RT

Tel: 020 7799 7900

Fax: 020 7799 7901

Media Team: 020 7799 8004 / 8005 / 8006