



**Consumer
Focus**
Campaigning for a fair deal

Consumer Focus submission to the Office of Fair Trading High Cost Consumer Credit Review

September 2009

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 are the voice of consumers, 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 coherent consumer advocacy, with a single organisation speaking with a powerful voice and able to more readily bring cross-sector expertise to issues of concern.

Submission to the Office of Fair Trading High Cost Consumer Credit Review

Consumer Focus is concerned about the issue of high-cost consumer credit. Recent research highlighted the spiral of debt that low-income families can face as a result of high-cost credit, as they are forced to borrow more debt to pay their outstanding commitments.¹ Qualitative research conducted by Consumer Focus Wales in 2009 has shown that although low-income consumers are unhappy about the high interest rates of home credit companies, they feel they have little choice but to use them. In addition, previous research has shown that home credit users prefer to use personal recommendation and word of mouth to choose providers and tend to build up relationships with home collection agents whom they trust.

Research by our predecessor organisation, the National Consumer Council (NCC), also found that many of the reasons why vulnerable consumers use home credit are similar to why they are put off by formal banking. These include a fear of greater indebtedness due to penalty charges as a result of defaulting on loans, lack of trust or familiarity with mainstream financial institutions, and incompatibility with low-income budgeting. However, there are elements of home credit that they find positive. Home credit has 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.

Users of high-cost credit are generally on low incomes and from more disadvantaged groups. Mainstream financial institutions are often less interested in this group of consumers, who they regard as high risk and low profit. They tend not to provide services that meet the specific needs of this group, which include the ability to borrow small amounts of money on a weekly repayment basis with no penalty charges for default. Government initiatives to encourage the banking industry to provide basic bank accounts have led to an increase in numbers of those who have bank accounts, although 2.1 million people remain without bank accounts (Financial Inclusion Taskforce, December 2008). New provision by the banking industry could be an initiative that would have a similar impact on access to affordable credit. It is only a year since the intervention of Government rescued certain banks and the banking system from collapse; the banking industry should be prevailed upon to make its lending services more accessible as part of corporate social responsibility towards the most disadvantaged and vulnerable groups in society.

¹ Below the Breadline, Barnardo's, 2009
http://www.barnardos.org.uk/11325_breadline_report_final.pdf

High-cost credit takes a number of forms. Home credit or 'doorstep lending' is a prevalent form of high-cost credit among low income groups (2.3 million²), particularly those in receipt of welfare benefits. NCC carried out extensive research in the area of home credit in 2004.³ It found a number of factors that militated against competition in the home credit market, to the detriment of an already vulnerable consumer group. A super-complaint to the Office of Fair Trading led to a Competition Commission investigation of the high-cost credit market, which confirmed that the home credit market was uncompetitive. A number of measures were proposed to introduce more competition to the market, including:

- Lenders to share data on customers' payment records
- A price comparison website for home credit providers
- Borrowers to be provided with clear account statements
- A fair rebate for the early repayment of loans

The *lenderscompared* website is the independent website set up following the Competition Commission's investigation. However, 35 per cent of families have no internet access and just under half of non-internet users are in the DE socio-economic band (*The Digital Divide*, Consumer Focus, 2009). Furthermore, they are likely to have low literacy and may not be comfortable using the internet. In terms of financial literacy, consumers in this group tend to look at loans in terms of weekly payment amounts rather than total interest paid. Home credit users tend to use personal recommendation and word of mouth to choose lenders, so comparison information of this nature may only have a limited impact.

Users of home credit are not generally in a position to exercise a high degree of bargaining power. They often have to use the money they borrow just to live on and they are not in a position to go to mainstream lenders if they do not like the interest rates of the home credit suppliers.

The amount of competition in the home credit market has recently diminished as a result of Cattles, one of the major providers in the home credit industry, going into administration. Furthermore, the restriction on lending by mainstream financial institutions may push those who have previously been able to use affordable credit from banks and building societies into the high-cost credit market, meaning that there is even less scope for consumers to exert bargaining power over the home credit providers.

Providers of home credit have claimed that their interest rates are justified because of the high costs of home collection and the high risk of default among their customer base. A recent feasibility study funded by the Joseph Rowntree Foundation⁴ produced a model for a not-for-profit home credit business that would need to charge a 123 per cent APR with a subsidy of £18m to become sustainable over 10 years. However, NCC's previous research found that, even allowing for the costs of home collection, the average APRs for home credit providers were still high. It was also felt that the providers were exaggerating the risk of default as the loans were short-term and borrowers often prioritised home credit loans above other household payments. In addition, if restrictions on the availability of mainstream credit mean that higher income borrowers are entering the home credit market, the risk of default among the general customer base will decrease and the level of interest will be increasingly difficult to justify.

² Competition Commission Home Credit Inquiry: Final Report (2006)

³

http://collections.europarchive.org/tna/20080804145057/http://www.ncc.org.uk/nccpdf/poldocs/NCC062pd_home_credit.pdf

⁴ 'Is a not-for-profit home credit business feasible?', Joseph Rowntree Foundation (March 2009)

Payday lending is another form of high-cost credit. These loans are generally available to those in low paid work and with access to a bank current account, so tend to reach a different client group to home credit users. Interest rates in this sector are often even higher than for home credit at 1,000 per cent APRs and above. Pay-day lending is offered on the basis that is a short-term loan, but many debts in this sector are 'rolled over'. Studies in the United States show that 90 per cent of loans go to borrowers with five or more loans per year.⁵ Credit checks are not always required and there are concerns about the scope for irresponsible lending in this area.

Consumer Focus has identified payday loans as a potential growth area during the recession due to the increasing restrictions on mainstream credit available to low income earners. In the US, concerns about the detriment they have caused to consumers have led to 15 states and the District of Columbia introducing a cap on interest rates.

Rent-to-own shops on the high street (eg, Brighthouse, formerly Crazy George's) are another form of high-cost credit. Consumers pay rent for an item which they do not own until the end of the rental period, by then often having paid several times the cost of the item's normal retail price. Log-book loans are high interest loans secured on a vehicle.

A cap on interest rates has been proposed as a possible solution to the issue of high-cost credit. Our predecessor organisation, NCC, did not support an interest rate cap. It was concerned that this would drive home credit providers out of the market or make them restrict their services to higher income groups. This would lead either to the increased poverty of vulnerable groups who use home credit providers or else force them to resort to illegal moneylenders (loan sharks). Nonetheless, it remains a concern that the poorest in society are paying for such high-cost credit merely to live.

Interest rate caps should not be considered without viable alternatives of low cost credit being widely available to low income groups. Credit unions are often put forward as a solution to high-cost credit. There is clearly scope for them to provide a lower-cost alternative to vulnerable consumers, but they vary greatly in size and capacity.

A number of credit unions have been involved in financial inclusion initiatives, but currently only a small number of credit unions are a credible alternative to traditional banking services, although there is scope to build capacity in this area. However, many credit unions require borrowers to save prior to being able to borrow and currently operate on a relatively small scale and have a limited infrastructure.

Community Development Finance Institutions (CDFIs) provide financial services to individuals and organisations in order to create wealth in disadvantaged communities or under-served markets. They are still a relatively small sector in the UK, but appear to offer possibilities for the expansion of affordable lending. Credit unions are limited in the amount of interest they can charge on their loans (a maximum APR of 26.8 per cent) and CDFIs have greater flexibility in setting interest rates. CDFI APRs can range between 25 per cent and 50 per cent.

⁵ Centre For Responsible Lending, Springing the Debt Trap
<http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.html>

The Social Fund should also be a source of affordable borrowing for vulnerable families, but restrictions on eligibility, the bureaucratic applications process, a high rejection rate and the cash-limited fund mean that it does not provide a ready alternative for many of those in need. The Consumer White Paper announced a review of the Social Fund. A much reformed Social Fund with additional funding and more extensive eligibility requirements would be required to meet the level of demand for low cost credit by consumers in need.

The consumers using the different types of high cost credit tend to be from the most disadvantaged socio-economic groups. We consider that it is an area that requires urgent attention in order to prevent the potential exploitation of consumers in the greatest financial need.

Consumer Focus submission to the Office of Fair Trading High Cost Consumer Credit Review

Written by: Marie Burton, Consumer Focus

www.consumerfocus.org.uk

Copyright: Consumer Focus

Published: September 2009

If you require this publication in Braille, large print or on audio CD please contact us.

For the deaf, hard of hearing or speech impaired,
contact Consumer Focus via Text Relay:

From a textphone, call 18001 020 7799 7900

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 8005 / 8006