



**Consumer  
Focus**  
Campaigning for a fair deal

# **Consumer Focus response to the Office of Fair Trading consultation on Irresponsible lending – OFT guidance for creditors**

October 2009

# Contents

## 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.

## Overall response

Consumer Focus is concerned about the issue of consumer over-indebtedness and the severe financial and emotional difficulties this can cause for vulnerable consumers and their families. We agree with the OFT's view that irresponsible lending has contributed to the problems of unsustainable credit that many disadvantaged consumers are facing (Citizens Advice Bureaux are now dealing with 9,300 new debt problems every day, Credit Action, October 2009).

Therefore, we welcome this comprehensive guidance from the OFT. It provides clarity on those practices which will not be considered acceptable by the OFT, thus enabling financial services providers to act in a fair and responsible manner. There is little within this draft guidance with which we disagree. Below we set out in more detail our responses to the questions raised in the consultation and highlight where we feel the guidance could be improved. One area of improvement would be having a separate section which deals expressly with vulnerable consumers and the particular issues they may face.

Nonetheless, we should like to preface our comments by stating that, overall, we consider this guidance is a positive development in the field of consumer credit and it will have a significant impact in reducing the use of irresponsible lending practices by financial services providers.

# 1 Introduction

**Q1 Does the introductory chapter set out the OFT's general view on the scope of what might constitute irresponsible lending practices, and the legal test for irresponsible lending, sufficiently clearly?**

We consider that the introductory chapter is clear on these issues. We agree with the OFT's view that this guidance should cover all stages of the lending process, including pre-contractual matters such as advertising and marketing. It is essential to consider the context of a business practice when deciding whether or not it is irresponsible; some business models will need to be considered as a whole when looking at whether they constitute irresponsible lending.

In view of the variety of consumer credit products and the fast-changing nature of the financial services market, we are in favour of the OFT's approach in identifying key principles and giving examples of types of behaviour that are likely to constitute irresponsible lending, rather than trying to produce a list of all possible irresponsible lending practices, which would soon become obsolete. We agree that the appropriate approach is to expect consumer credit business to comply with the word and the spirit of the guidance.

**Q2 Are there any substantive aspects with which you disagree?**

No.

**Q3 Do you consider there are any significant omissions?**

No.

**Q4 Do you have any suggestions for improvement?**

No.

## 2 General principles of lending

### **Q5 Are the draft guidelines on the general principles of lending sufficiently clear?**

We consider the draft guidelines on the general principles of lending are clear and comprehensive. They form a useful general statement on the conduct expected of creditors and we agree that they should be regarded in this way.

We are firmly of the view that creditors should be responsible for the actions and omissions of brokers, debt recovery businesses and other intermediaries or agents who act on their behalf. It is encouraging that the guidance makes this clear.

In view of the difficulties which a number of consumers have faced with regard to increasing, aggregating or rolling over debt, we are pleased that the guidance makes clear that creditors should not encourage this type of behaviour when borrowers are experiencing problems with repayment.

Similarly, we support the proposals in the guidance regarding the requirements for transparency and proportionality in dealings between creditors and borrowers.

### **Q6 Are there any substantive aspects with which you disagree?**

No.

### **Q7 Are there any significant omissions?**

We welcome the reference to creditors being expected not to target vulnerable consumers, as defined by paragraph 2.6, with unsuitable products. However, the guidance would be strengthened if it dealt with the need for particular care when dealing with vulnerable consumers as a fundamental principle of the guidance as a whole, rather than with regard to this specific provision only.

Consumers who are vulnerable due to indebtedness, poor credit rating, or because of their age, health or disability, are likely as a category to be among those most at risk of suffering from irresponsible lending practices. The guidance would be improved by particular detailed information in relation to this group in a separate section.

### **Q8 Do you have any other suggestions for improvement to this section?**

See answer to Q7.

## Explanations of credit products

### **Q9 Are these draft guidelines on explanations of credit products sufficiently clear?**

We consider the draft guidelines on explanations of credit products to be clear. We agree that transparency is essential in dealings between creditor and borrower, but would like to make clear that transparency alone is not sufficient to make lending responsible; products must also be available on fair and reasonable terms.

We agree that explanations should be provided in a personalised manner, appropriate to the borrower. For certain consumers, this will involve a verbal explanation in plain language, followed by written confirmation, also written in an accessible way which includes a translation if appropriate.

We welcome the requirement for borrowers to receive an additional verbal explanation of certain elements of the transaction, as set out in paragraph 3.11 of the guidance with reference to telephone and face-to-face transactions. For certain vulnerable consumers, a verbal explanation is probably the most effective way of ensuring they are aware of the terms and conditions of the agreement and the consequences of default; this should extend to online deals.

In view of the recent increase in charging orders being made in the courts, we are pleased that the guidance requires consumer credit businesses to inform borrowers that default on unsecured loans could result in a charge on their property. In addition, creditors should be required to explain that this could result in their property being repossessed.

It is important for prospective borrowers to have access to independent advice on credit agreements and that this should include not-for-profit advice agencies such as Citizens Advice. The provision that the creditor must inform the borrower that they can obtain advice should be strengthened to require the creditor to provide details of where to get advice (ie, without the borrower having to make a specific request) at the same time.

We find the guidance helpful in relation to additional information being provided regarding the specific special or unusual features of particular types of credit. It clearly sets out the information that creditors providing these financial services would be expected to give to borrowers.

We are also pleased that the guidance sets out specific irresponsible lending practices in relation to explanations of credit and we are in agreement with the areas identified.

### **Q10 Are there any substantive aspects of the draft guidelines on explanations of credit products with which you disagree?**

No.

### **Q11 Are there any significant omissions?**

In terms of the sources to which a borrower can be referred for further information or explanation, while we agree that comparison websites can be useful, it is important to remember that 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). Consumers on the lowest incomes are more likely to have problems with literacy. It will be important for borrowers to be referred to sources of information that are appropriate to their needs and abilities.

In relation to pawnbroking (paragraph 3.20), we suggest that, in the explanatory information, the creditor should also be required to tell the borrower what the time period would be before the pledge was sold.

With respect to on-line transactions, we are concerned that the provision of explanation screens may not be sufficient to prevent vulnerable consumers from entering into credit agreements they do not understand. We also believe, as previously stated, that borrowers should be provided with information signposting them to sources of not-for-profit, free and impartial financial advice without being required to request it.

Within the 'special features' section under paragraph 3.20, we consider the guidance should include specific reference to credit arrangements set up by coin-meter/meter-television businesses, as part of the range of 'linked credit' options. We understand that meter-television businesses use coin meters for payment as well as accepting payments by cash, cheque or direct debit. It should be made clear to consumers that where a coin meter is used, failure to put money into the coin meter will mean their television could stop working.

### **Q12 Do you have any other suggestions for improvements to this section?**

See answers above.

### **Q13 Where applicable, should borrowers be able to access telephone helplines free of charge?**

Yes.

### **Q14 Where applicable, should creditors be required to provide access to telephone helplines at point of sale?**

Yes, if it is not possible for an oral explanation to be provided to the borrower otherwise (eg, on-line). If helplines are to be provided, they should be available in a comfortable, relaxed and quiet environment, which will give the borrower the opportunity to understand the information they are being given and ask any questions necessary for them to make an informed decision about borrowing.

### **Q15 Where a borrower has entered into a long-term credit agreement, should the creditor be required to repeat aspects of the explanation of the credit product during the term of the agreement and, if so, how frequently?**

We support a requirement for creditors to repeat aspects of the explanation of the product during the life-time of the agreement on an annual basis.

## 4 Assessment of Affordability

### **Q16 Are these draft guidelines on assessment of affordability issues sufficiently clear?**

We consider that the assessment of affordability is a key feature of any test of irresponsible lending and we welcome the approach that the guidance takes on this issue. In our view, the guidance has been written clearly. We agree that the assessment of affordability must include the impact of the loan on the borrower's overall financial well-being and not simply whether the borrower will be able to repay the loan in question. We also support the definition of 'in a sustainable manner' set out in the guidance.

We acknowledge that, as described in paragraph 4.6, there may be circumstances where a temporary reduction in income may not preclude the grant of credit, for example, if the period of reduction is fixed in advance, but we would not want to see this provision used to justify irresponsible lending. It will require that the constituent elements of assessing affordability are given full consideration when a decision is being made about irresponsible lending practices, to minimise the risk of this happening.

We agree that a high level of scrutiny must be undertaken for second and subsequent mortgages or loans.

We welcome the guidance in terms of specific irresponsible lending practices in relation to the assessment of affordability and we agree with the areas identified in this section.

### **Q17 Are there any substantive aspects of the draft guidelines on assessment of affordability issues with which you disagree?**

No.

### **Q18 Are there any significant omissions?**

No.

### **Q19 Do you have any other suggestions for improvement to this section?**

While we recognise that borrowers have a responsibility to give creditors accurate information, it is also the case that, unless they are required to provide evidence, borrowers may exaggerate their income, for example, by using a figure based on previous bonuses or by minimising expenditure, in order to obtain credit. If creditors were required to obtain evidence from consumers, it could have the benefit of both reducing irresponsible lending and irresponsible borrowing.

It is difficult to see how creditors who do not require any information on income or expenditure from the borrower would be able to claim that their lending is based on a proper assessment of affordability. We agree that self-certification should not be considered adequate for large, long-term loans, particularly those secured on property. It would be appropriate to introduce a presumption that lending is irresponsible unless evidence of income and expenditure is required by the creditor. The creditor will be able to rebut the presumption by explaining how the other means and sources of information they use are sufficient to make a proper assessment of affordability.

The guidance states that the OFT considers that, generally, loans for small amounts would not require the same level of scrutiny as large sum or long-term loans. However, there are loans for small amounts that are sold on the basis of being short-term, but which, due to repeated short-term loans or 'roll-over', can result in high levels of consumer detriment. We believe that the appropriate level of scrutiny for a loan should be determined by the context of the borrower's overall financial circumstances. The likely impact of the loan on the borrower's overall financial well-being should be a governing factor in this regard.

## Pre-contractual issues

### **Q20 Are the draft guidelines on pre-contractual issues sufficiently clear?**

We consider that the draft guidance on unsatisfactory business practices and procedures is clear (with one proviso, see below) and we are in agreement with the issues identified. On the issue of clarity, in the pre-contractual issues section it has not been stated clearly (ie, with a heading to this effect) that all the practices described are 'specific irresponsible lending practices'. This may be a drafting issue; however, it is evident the practices identified are irresponsible lending practices and they should be clearly designated as such.

We agree it is important that advertising and promotional material should not indicate that loans are available regardless of the borrower's financial circumstances, without an assessment of affordability or based on equity alone.

We welcome the provisions which make clear that the creditor is under an obligation not to promote products which are, or they have reason to suspect may be inappropriate to that borrower's needs. We are pleased that the guidance states specifically that a creditor should be alert to issues of the borrower's mental capacity, both in providing credit and in giving effect to lending which is not in the creditor's best interests. However, the guidance would benefit from a section that deals with how vulnerable consumers, including those with mental health or learning disability issues, should be treated by creditors.

We question the inclusion of the word 'clearly' in paragraph 5.6. This seems to be an unnecessary qualification. We believe the paragraph should state that 'giving effect to a lending decision which is not in the borrower's best interests' is sufficient for this purpose.

Physical/psychological pressure may have an impact on a disadvantaged consumer's decision to enter into a credit agreement and we agree it should be included in unsatisfactory business practices. We are concerned that offering a borrower a larger amount than they request might not be considered an unsatisfactory practice. This would seem to be encouraging greater indebtedness, which is stated to be unsatisfactory in paragraph 5.13. There should be a presumption that lending more than is requested is an irresponsible practice unless the creditor can justify the decision based on the circumstances of the borrower. They should also confirm that they assessed the affordability of the loan and that the borrower was not pressurised in any way to accept the offer with no inappropriate inducements offered.

We welcome the guidance with regard to deceptive and/or unfair practices, but as stated above, it should be made clear that all the provisions within section 5 of the document are considered irresponsible lending practices. Creditors should be obliged to disclose commission automatically, rather than disclosure being reliant on the borrower's request.

**Q21 Are there any substantive aspects of the draft guidelines on pre-contractual issues with which you disagree?**

See answer to Q20.

**Q22 Are there any significant omissions?**

See answer to Q20.

**Q23 Do you have any other suggestions for improvements to this section?**

See answer to Q20.

## Post-contractual issues

**Q24 Are the draft guidelines on post-contractual issues sufficiently clear?**

Broadly, the draft guidelines are sufficiently clear in respect of post-contractual matters. Again, however, we note that there is no heading which expressly states that the practices described in this section are all 'specific irresponsible lending practices'. It should be clearly stated that they are irresponsible. As stated above, we endorse the OFT's decision that irresponsible lending should cover all aspects of the lending process including post-contractual matters and default.

We agree with the post-contractual practices and procedures identified by the guidance as unacceptable. We particularly welcome the express statement within the guidance that repeated roll-over of a short-term credit agreement is not acceptable practice and that payday loans are not an appropriate mechanism for financing long-term borrowing.

**Q25 Are there any substantive aspects of the draft guidelines on post-contractual issues with which you disagree?**

We do not think there should be an exception to notice requirements for increasing interest rates when they are linked to an external reference rate that is publicly available.

**Q26 Are there any significant omissions?**

It is essential that borrowers experiencing difficulties should receive independent debt advice at the earliest possible opportunity. An appropriate action creditors should take with borrowers who show signs of problems with repayment is to provide them with details of not-for-profit debt advice organisations.

**Q27 Do you have any other suggestions for improvement to this section?**

We consider the requirement under paragraph 6.7 to provide notice in writing of any variations to be important. In terms of 'adequate' notice, while we understand this will vary depending on the size and nature of the debt, there should be a set minimum period of 30 days' written notice of variation for all credit agreements (in line with the Statement of Fair Principles agreed at the 'Credit Card Summit').

The requirement to explain to a borrower in advance of the order of debt allocation should be delivered in simple language and in a manner appropriate to the ability and understanding of the borrower. It should be stated that for certain borrowers, such as those with limited literacy skills or poor English, a verbal explanation would be necessary to satisfy this requirement.

## Handling of default and arrears

### **Q28 Are these draft guidelines on the handling of default and arrears sufficiently clear?**

The issue of how a creditor acts in relation to matters of default and arrears is a fundamental aspect of responsible lending. The guidelines are clear but we note that the practices set out in this section are not designated by a heading as specific instances of irresponsible lending practice. As previously stated, we consider it important that this should be the case to avoid any doubt on the part of creditors.

In addition, paragraph 7.1 states that creditors' policies for dealing with arrears should make specific provision for dealing with vulnerable consumers. Paragraph 7.12 sets out these responsibilities when dealing with a borrower where there are issues around mental health. The guidance would benefit from a section dedicated to dealing with the specific needs of vulnerable consumers and the policies and procedures that creditors would be expected to adopt when dealing with borrowers who fall into this category.

We agree with the requirements to treat borrowers in default or arrears difficulties 'with understanding and due consideration' and 'with forbearance'. We understand the OFT has drawn up the guidance in this way in order to deal with the broad range of circumstances, creditors, borrowers and credit agreements to which the guidance will apply. It is important to make clear that each situation will be judged on its own merits and the examples given of ways in which the OFT would expect creditors to treat borrowers in default are not intended to express the limits of the OFT's expectations of creditors.

We are aware of recent problems in respect of assignment/transfer of debt and we are pleased to see the guidance in this regard. It is essential that creditors provide accurate information when passing on debt to debt collectors or selling it to debt purchase businesses. Where there is a dispute about the identity of the debtor, pursuit of the debt should be suspended until the dispute has been resolved. We also agree it is the responsibility of the business seeking to recover the debt to prove that the individual concerned owes the debt; it is not for the individual to prove that they are not the debtor.

### **Q29 Are there any substantive aspects of the draft guidelines on the handling of default and arrears with which you disagree?**

No.

### **Q30 Are there any significant omissions?**

As stated above, we believe it is essential that borrowers experiencing difficulties are directed towards independent debt advice providers at the earliest opportunity. Therefore, when providing 15 working days' written notice to borrowers of their intention to institute proceedings (as required by paragraph 7.8), creditors should also be obliged to include details of not-for-profit debt advice organisations in any such notice.

### **Q31 Do you have any other suggestions for improvement to this section?**

In terms of providing statements to borrowers when they go into default, we think the provisions should be strengthened to require creditors to provide information more regularly than every six months in cases of serious arrears or default or, where interest or default charges have been added to the account. When informing borrowers of such charges, these amounts should be shown clearly and separately from the principal amounts owed on the account.

Where creditors transfer or assign their debt to a third party debt recovery business, we believe that any behaviour on the part of the debt recovery business that does not meet the requirements of the guidance should be considered as a failure to comply with the guidance by the original creditor.

The requirement on the creditor to provide notice of transfer to the borrower is particularly important. However, the phrase 'adequate' should be replaced with a maximum period of seven days' in which to notify the borrower of assignment/transfer of the debt.

In terms of taking steps to possess property, the guidance would benefit from clarification on the definition of 'other than as a last resort'. We appreciate this may differ depending on the size and nature of the loan; however, in terms of second charge mortgages and loans, we suggest that the definition of 'as a last resort' should include as a minimum that the arrears exceed a minimum of six months' payments and the equity in the property should be insufficient to safeguard the creditor's capital.

A creditor providing second charge mortgages and secured loans should not be able to reject any reasonable offer to repay the debt by instalments and a reasonable offer should be considered as one which will pay off the debt in full over the remaining lifetime of the mortgage (in line with *Cheltenham and Gloucester BS v Morgan* [1996] 1 All ER 449). Moreover, all possible options should have been explored with the borrower, including the possibility of freezing interest and other charges, extending the mortgage term or agreeing a payment holiday without the accrual of further interest during the break in payments. The borrower should also have had a full opportunity and been advised to claim all possible welfare benefits and have no outstanding benefit claims (or appeals) prior to a possession claim being taken.

We are pleased that the guidance makes clear that, while there is currently no pre-action protocol in mortgage arrears cases in Scotland, creditors in Scotland will be expected to apply the same practice and principles in mortgage arrears cases.

### **Q32 Should a debt recovery business delay pursuance of a debt from a borrower lacking the capacity to make decisions relevant to the debt recovery process, unless the borrower has someone managing his affairs pursuant to a Lasting Power of Attorney or an order of the Court of Protection?**

Yes. It would be unacceptable for a debt recovery business to take steps against a borrower who lacked the capacity to manage their own affairs and had no-one else responsible for doing so.

## Regulatory compliance and enforcement

### **Q33 Are these draft guidelines on regulatory compliance and enforcement sufficiently clear?**

We believe the draft guidelines are clear on this issue. We welcome the approach towards compliance and enforcement set out in the guidance; it will be of substantial benefit to consumers. The measures taken in relation to compliance and enforcement will be fundamental to the effectiveness of the guidance in preventing irresponsible lending practices.

As stated above, we are in agreement that the fitness of a creditor can be considered as a result of the behaviour of a third party with which it does business. We agree that it is appropriate for creditors to take appropriate care when selecting the third parties with which it will conduct business relationships.

We are pleased that it is made clear that it will be for creditors to positively demonstrate to the OFT that they have complied with the OFT's requirements and to have the documented policies and procedures in place to do so.

### **Q34 Are there any substantive aspects of the draft guidelines on regulatory compliance and enforcement with which you disagree?**

No.

### **Q35 Are there any significant omissions?**

No.

### **Q36 Do you have any other suggestions for improvement to this section?**

No.

This section reflects the situation as it stands and articulates the powers of the OFT in this regard. However, where a creditor has failed to comply with the guidance, the borrower remains bound by the terms of the agreement. This is particularly important where the lending has been irresponsible but the relationship has not been found to be 'unfair' under s140A Consumer Credit Act 1974 (which would give the court scope to intervene in the contract), although, in our view, a finding of irresponsible lending could be a strong basis for claiming that the relationship between creditor and borrower is unfair.

We consider court rules should be amended so that the courts can consider whether (and the extent to which) the creditor complied with this guidance when determining a creditor's claim for recovery of the debt.

## Timing of a business compliance review

The OFT has sought views on the appropriate time period to initiate a compliance review. We consider that a review after a year would be appropriate. This would give consumer credit businesses enough time to ensure they had the policies and procedures in place that are required by the guidance.

## Conclusion

This guidance represents a significant and positive step in protecting consumers from irresponsible lending practices; in particular, the protection of those most vulnerable and at risk of over-indebtedness. We are committed to working with the OFT in ensuring the effectiveness of measures taken in respect of this issue.

## **Consumer Focus response to the Office of Fair Trading consultation on Irresponsible Lending – OFT guidance for creditors**

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