

Consumer Credit Bill

Full Regulatory Impact Assessment

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Introduction

1. General

- 1.1 In December 2003 the Government published a White Paper – *“Fair, Clear and Competitive – the Consumer Credit Market in the 21st Century”* (the “White Paper”). This followed a two-year review of the UK’s consumer credit laws, with extensive consultation with a wide range of stakeholders. The White Paper identified a considerable number of problems with the regulation of consumer credit, and identified the reforms necessary to modernise the Consumer Credit Act 1974 (the “Act”) and make it more effective.
- 1.2 The proposed reforms to the Act are part of the Government’s Consumer Credit Review. Much has already been done:
- (a) in June and October 2004, new Regulations were made, which reform the requirements for pre-contractual conduct and disclosure by consumer credit businesses¹ and the rules in relation to early settlement; and
 - (b) in July 2004, the DTI, with the Department for Work & Pensions, published an Action Plan for tackling the problem of over-indebtedness.

Devolution: the changes will apply to the whole of the UK. The responsibility for consumer credit regulation is transferred to Northern Ireland under the devolved settlement. However, the Minister with responsibility for consumer protection in Northern Ireland wrote to the Parliamentary Under-Secretary of State for Employment Relations, Competition & Consumers² to ask that the proposed amendments to the Act extend to Northern Ireland.

¹ We have used the term “consumer credit business” to cover all businesses involved in the consumer credit industry and regulated by the Act. It is not necessarily used in the sense defined in the Act. Where appropriate, we have also used the term “lender”, where the changes will apply only to that limited class of consumer credit business.

² Now Parliamentary Under-Secretary of State for Employment Relations & Consumer Affairs.

2. The form of this RIA

This RIA deals with the proposed amendments to the Act and is divided into two sections dealing with:

Part 1

- (a) an overview of the regulatory impact of our proposed reforms, including:
 - (i) a review of existing consumer detriment in the consumer credit market;
 - (ii) an outline of our proposed reforms, in respect of:
 - (A) improving consumer rights and redress;
 - (B) improving regulation of consumer credit businesses; and
 - (C) making regulation appropriate for different types of consumer credit transaction; and
 - (iii) the impact of our preferred options, dealing with:
 - (A) consumer benefits;
 - (B) the costs to a typical business;
 - (C) the impact on small business;
 - (D) the impact on competition;
 - (E) enforcement and sanctions;
 - (F) monitoring and review; and
 - (G) consultation.

Part 2

- (b) specific regulatory impact assessments for each of the three main reform areas:
 - (i) improving consumer rights and redress;
 - (ii) improving regulation of consumer credit businesses; and
 - (iii) making regulation appropriate for different types of consumer credit transaction,each including an analysis of:
 - (A) the costs to a typical business;
 - (B) the impact on small business; and
 - (C) enforcement and sanctions,in respect of the preferred option in each area.

Part 1

The regulatory impact of the Consumer Credit Bill: an overview

3. Introduction

- 3.1 This first part of this RIA sets out an overview of the regulatory impact of the proposed reforms. It is divided into three parts:
- (a) identifying the problem - consumer detriment and consumer credit;
 - (b) an outline of our proposed reforms to the Act; and
 - (c) an overview of the regulatory impact of our proposed reforms to the Act.

Identifying the problem - consumer detriment and consumer credit

4. Consumer detriment and consumer credit

- 4.1 The Act has not provided sufficient protection for consumers where they have been unfairly treated by consumer credit businesses. The rights that the Act accords to consumers and the avenues it provides to them to challenge unfair conduct are restricted. Furthermore, the Act has provided regulators with insufficient powers to tackle improper or unfair conduct by consumer credit businesses.
- 4.2 The vast majority of consumer credit businesses do treat consumers fairly and reasonably and comply with their statutory obligations. These businesses resolve disputes informally and quickly and take effective steps to rectify instances of non-compliance. However, a small proportion of businesses do not, often with devastating consequences for individual consumers. The current weaknesses in the Act have allowed these unscrupulous consumer credit businesses to exploit the difficulty consumers have in obtaining redress so as to act unfairly or in breach of general standards of good conduct, and inflict considerable harm on consumers.
- 4.3 The DTI has collected a considerable amount of information about the harm to individual consumers resulting from the practices of some consumer credit businesses which are either unfair or in breach of general standards of good conduct.³ So that we can

³ The DTI has commissioned and produced a considerable amount of research into the impact on consumers of exploitative conduct in consumer credit transactions. This is referred to in the White Paper and in the Action Plan on Over-indebtedness. Copies of relevant reports and papers are available on the DTI website. In addition, officials have conducted research visits to review individual case reports and complaint information at the Gloucestershire Money Advice Service, Leeds Money Advice Support Unit, Citizens Advice Scotland's Social Policy Unit, Citizens Advice (England & Wales)'s Social Policy Unit, Citizens Advice's Wolverhampton Specialist Support Unit, the Bristol Debt Advice Centre and Lincoln CAB. We have not been provided with any information that is confidential to a borrower other than with that individual's consent. In reviewing case files we reviewed all enquiries received on consumer credit issues over a specific period.

indicate the extent of consumer detriment more accurately, we have also reviewed evidence of the number and nature of enquiries made by consumers to government bodies and advice providers, and this information is set out below. However, using information derived from enquiries and complaints is only one way of assessing consumer detriment, and it is extremely difficult to quantify consumer detriment resulting from existing lending practices which are either unfair or in breach of general standards of good conduct.⁴

5. The potential scale of the problem

- 5.1 Consumer credit borrowing is ubiquitous in modern British life. Personal debt levels (excluding first and second charge mortgages) have increased significantly over the past five years, with approximately £170 billion outstanding as at July 2004 (compared to approximately £70 billion in 1993).⁵ In July 2004 alone, the members of the Finance & Leasing Association lent a total of c.£1.3 billion in direct unsecured loans to consumers.⁶
- 5.2 The vast majority of consumers can manage consumer borrowing without problems.⁷ With the increase in the use and size of consumer borrowing, increasing numbers of people are reporting problems in dealing with consumer credit, most commonly because of issues associated with multiple borrowing and over-commitment, but often because of problems associated with sales practices or the way in which consumer credit businesses administer credit agreements.
- 5.3 In addition, potentially some 9 million consumers lack the credit rating needed to borrow mainstream products from high street lenders. Just over 50% of this group are self-employed and have difficulty in proving their incomes. Another 30% have credit ratings impaired by County Court Judgments⁸ or arrears. Just under 20% are on benefit of some kind.

6. Causes of consumer detriment

- 6.1 On the basis of the work that the DTI has done in this area we have identified that consumer detriment arises as a consequence of four main areas of concern:
- (a) unfairness in respect of any aspect of the consumer credit relationship, and most particularly in relation to:

⁴ We have considered OFT's survey of Consumer Detriment published in April 2000, which quantifies the total level of consumer detriment for all consumer issues (not only consumer credit) to an amount of approximately £8.3 billion a year.

⁵ See Data Monitor, Financial Statistics Table 3.2B.

⁶ FLA, *Monthly Statistics - July 2004* at http://www.fla.org.uk/fla_home/press_releases/070904.htm

⁷ See Kempson, E (2002) *Household Survey of Over-indebtedness*, DTI

⁸ Or their equivalents in Scotland and Northern Ireland.

- (i) the use of misleading and unfair selling methods, including irresponsible lending
 - (ii) the administration of the agreement (including the abuse of a lender's discretionary powers to vary terms or the manner in which they operate);
 - (iii) unfair treatment of accounts in arrears; and
 - (iv) a lack of transparency in the way fees and charges are applied to accounts;
- (b) the inability to seek effective redress through an accessible or efficient mechanism;
 - (c) poor customer service; and
 - (d) the imposition of excessive costs of credit (both in terms of interest rate charged and the amount of fees and charges applied to the account).

In many instances where a consumer makes an enquiry; their situation will raise a combination of these issues.

6.2 In setting out our concerns about these practices, we acknowledge that personal responsibility is an important aspect of all consumer credit relationships and should be an important consideration in any analysis of the full extent of consumer detriment.

6.3 Working with industry, the Government has taken steps to improve the provision of clear, concise and accurate pre-contractual information to consumers and also to improve the transparency of agreements through the introduction of new regulations.⁹ These reforms will improve the position for many consumers in their pre-contract dealings with consumer credit businesses and reduce the scope for inappropriate conduct by lenders. However, these reforms do not directly address the considerable scope for abuse that exists as a consequence of unfair selling practices and irresponsible lending, nor the problems that can arise after a contract has been signed despite compliance with procedural requirements.

7. Consumer credit problems

7.1 We estimate that in 2002-2003 the UK's main free advice providers¹⁰ received c.2.5 million enquiries about a consumer

⁹ See Consumer Credit (Advertisements) Regulations 2004, Consumer Credit (Agreements)(Amendment) Regulations 2004, Consumer Credit Disclosure of Information) Regulations 2004 and the Consumer Credit (Early Settlement) Regulations 2004. These Regulations were made in June 2004. Also see Consumer Credit (Miscellaneous Amendment) Regulations 2004, made in October 2004.

¹⁰ This figure does not include consumers who seek advice from fee-paying advice providers such as solicitors, accountants and debt management companies. We have included figures from CAB (in both England & Wales and Scotland), Advice UK members, the National DebtLine, local authority advisory services, the Office of Fair Trading, the Financial Ombudsman Service ("FOS") and Consumer Credit Counselling Service.

credit problem, which represents c.600,000 individual consumers.¹¹ This figure does not include those consumers who either:

- (a) could, but did not make an enquiry; or
- (b) tried to make an enquiry but could not get through to an advice provider;¹²
- (c) made enquiries directly to credit providers or sought advice from a paid adviser.

We believe that since that period these figures have increased, due to more demand for these services and additional available funding for their provision.

7.2 For those bodies that are not exclusively focussed on money advice, enquiries about consumer credit formed a large category of enquiries by volume.¹³ On the basis of this data, we have identified the following trends:

- (a) the number of consumer enquiries to free advice services about consumer credit is increasing;¹⁴ and
- (b) the total value of the credit that is the subject of these enquiries is increasing.¹⁵

7.3 A significant number of enquiries relate to issues associated with multiple borrowing and over-commitment. In many cases the resolution of these issues will depend on a commercial decision by a lender to accept lower rates of repayment, freeze interest or write-off some or all of a debt. However, based on our review of cases in advice agencies, many of these enquiries also pose issues

¹¹ NB we have endeavoured, so far as is possible, to exclude enquiries and complaints about mortgage lending and duplicate enquiries from this figure. This figure is based on 2002/2003 information provided to us by OFT (c.50,000 enquiries), FOS (c.2,500 enquiries), Citizens Advice (England & Wales) (c.835,000 enquiries), Citizens Advice Scotland (c.75,000 enquiries), Advice UK (c.600,000 enquiries, based on 4 debts for each of the 150,000 consumers who complain to Advice UK agencies) and also as set out in the British Standards Institute's Consumer Effectiveness Project, see: <http://www.bsi-global.com/All+About+Standards/Consumers/research.xalter>. We have divided the total number of enquiries to reflect that each enquiry represents a single debt and that consumers generally have multiple debts: estimated by Citizens Advice to be 4 per consumer (i.e. c.200,000 consumers). Advice UK has told us that c.150,000 consumers made enquiries to its agencies. The Consumer Credit Counselling Service receives enquiries from c.180,000 to 200,000 consumers a year (on the assumption that each consumer has 4 debts (using the same ratio as for Citizens Advice, this would mean that CCCS deals with c.800,000 enquiries a year)). National DebtLine deals with 45,000 consumers a year (and on the basis they each have 4 debts, deals with c.180,000 enquiries). We have also applied a 10% reduction to the total number of consumers to account for duplicate enquiries to different advice providers.

¹² e.g. Resource constraints on the National DebtLine mean that it can answer less than 50% of the calls made to it. Many of these may be repeat calls. Citizens Advice has long waiting lists of consumers who have sought assistance but whom they have insufficient resources to assist.

¹³ Citizens Advice Scotland states that of the almost 15% of the total number of enquiries made to it in 2003-2004 that relate to debt, 69% of all enquiries and complaints about debt issues related to consumer credit. Citizens Advice (England & Wales) estimates that 15% of complaints made to it relate to consumer debt. These figures exclude debt that relates to utilities, local authorities, student loans, housing and benefits.

¹⁴ Citizens Advice (England & Wales) estimates that there has been a year-on-year increase in debt problems of 3.1% since 2003: see Citizens Advice Annual Report 2003/2004 p.12. Citizens Advice Scotland estimates that there has been an increase in consumer credit enquiries over the past 4 years of c.3-5% per year.

¹⁵ Citizens Advice Scotland estimate that in 1999/2000 the total amount of debt that was the subject of an enquiry to its agencies was worth £60 million, in 2000/2001 - £70 million, in 2001/2002 - £93 million and in 2002/2003 - £122 million, a more than 100% increase since 1999.

in terms of responsible lending to consumers who are either vulnerable or at risk of becoming overly indebted.¹⁶

7.4 We have set out in the Annex an analysis indicating the scale of existing consumer detriment in the UK consumer credit market.

8. Wider impacts flowing from consumer credit problems

8.1 For a consumer, the problems associated with issues of multiple borrowing and over-commitment are serious and extend beyond the consumer credit problem to all aspects of their lives. A high proportion of the advice cases that we have reviewed involved consumers who are particularly vulnerable, and are on benefits, have mental health problems or learning difficulties or, if in employment, exist in a financially precarious state with a low income and without any assets to call upon.¹⁷

8.2 When faced with financial strain these consumers are often forced to rely, or to rely more heavily, on public services and welfare benefits. Consumer credit problems can create financial strain (leading to problems in dealing with other financial commitments such as utility and local authority debts) and impact adversely on the personal lives of those affected, including escalating health and other social costs and, for those who work, their productivity levels.¹⁸

8.3 We have not attempted to quantify these costs, but they are likely to be significant and add weight to the rationale for taking action to improve the effectiveness of consumer credit regulation.

¹⁶ We acknowledge that the issue of responsible lending and over-indebtedness is complex and dependent on issues associated with both the consumer credit business's and the borrower's conduct. However, our survey of advice agency cases has shown that a considerable number of debt advice cases where there is no dispute about the borrower's liability, do raise issues of problems associated with multiple borrowing and responsible lending and borrowing.

¹⁷ See Kempson, McKay and Willetts June 2004 *Characteristics of families in debt and the nature of indebtedness* a report for the DWP. See also DTI/DWP June 2004 *Tackling Over-indebtedness- Action Plan 2004*, pp.15-19.

¹⁸ See DTI (with DWP) July 2004 "Tackling Over-indebtedness - Action Plan 2004"; see also DTI December 2003 "Fair, Clear and Competitive – The consumer credit market in the 21st century", Annex 3.

Our proposed reforms

9. On the basis of the benefit and cost analysis set out in the specific RIAs in the second part of this document and our consultations with stakeholders, our proposals for reform are:
 - (a) **Consumer rights and redress** – Reform the extortionate credit test and introduce an Alternative Dispute Resolution (“ADR”) system (Option 2);
 - (b) **Regulation of consumer credit businesses** – Amend the Act to provide for more proportionate regulation (Option 3); and
 - (c) **Appropriate regulation of specific consumer credit transactions:** Remove the financial limit and provide for appropriate regulation (Option 2).

A consideration of the options available in relation to each of these reforms and a regulatory impact assessment of our proposals is set out in Part 2.

10. Our reform proposals in detail

Improving consumer rights and redress

- 10.1 **Unfair credit:** A new test as to whether a relationship is unfair will replace the existing extortionate credit test for the reopening of credit agreements where the transaction as a whole is found by a court to be unfair. This will be determined by reference to all the relevant circumstances including the terms of the agreement and the conduct of the parties.
- 10.2 **OFT enforcement powers:** The Office of Fair Trading (“OFT”) will be able to take enforcement action under Part 8 of the Enterprise Act 2002 against consumer credit businesses in respect of unfair conduct which causes a harm to the collective interests of consumers. OFT will also be required to issue guidance as to how it will exercise these powers before and after an agreement is made.
- 10.3 **ADR:** An Alternative Dispute Resolution scheme will be introduced that is mandatory for all businesses licensed under the Act. The ADR scheme will only be applicable once consumers have complained to the consumer credit business’s own complaints handling mechanism, and have exhausted all relevant options. The Financial Ombudsman Service (“FOS”) will provide the ADR system.
- 10.4 **ADR administration:** All businesses covered by the ADR scheme will be required to pay an annual levy, to be collected by OFT in conjunction with the licence fee and provided to FOS, to maintain the ADR scheme.

- 10.5 **Cost of ADR to parties:** Consumers will not be required to pay a case fee. The case fee will be met by the consumer credit business. The first 2 complaints to FOS per year will be free to the consumer credit business.

Improving regulation of consumer credit businesses

- 10.6 **Fitness test:** The fitness test will be broadened so that OFT will be given the clear power to assess the competence of a business to provide credit, looking ahead to likely future behaviour as well as checking for past misconduct and other offences.
- 10.7 **Indefinite licences and OFT oversight:** OFT will move to a system of indefinite standard licences and will be able to assess fitness in relation to specified activities within the licensable categories of business, to facilitate a more targeted and less burdensome approach. This means that OFT and businesses will not be burdened by the current five-yearly licence renewal processes. Group licences will remain renewable as the norm, to facilitate OFT's oversight of the group licence holder, who is responsible for ensuring members of the group are fit. It will also be possible to time limit standard licences where appropriate, for example where consumers may be at risk. OFT will be able to focus its resources on the monitoring and investigation of licence holders who give rise to concern so as to ensure they remain fit or, where they are deemed unfit, are the subject of regulatory action. There will be a periodic licence fee, replacing the current renewal fee.
- 10.8 **Intermediate sanctions:** To provide OFT with the power to apply intermediate sanctions (rather than having to rely on the potentially disproportionate tools of refusal, revocation, suspension, or variation of a licence) to tackle behaviour which causes detriment but does not render a business unfit. We propose OFT will be able to impose requirements on licences; breach of requirements will expose the business concerned to a financial penalty, which will be subject to a cap of £50,000. The Secretary of State will be able to amend this cap (to future proof this measure) through secondary legislation subject to the affirmative resolution procedure.
- 10.9 **OFT powers of investigation:** To enhance OFT's powers of investigation so that OFT can require by notice the production of information by licensees whenever that information is required by OFT for the exercise of its functions under the Act and from third parties in specified circumstances. We also propose to provide OFT with the power to enter premises (other than those used solely as a dwelling) on reasonable notice, and to apply for a warrant to enter and search when a notice requesting information has not been complied with. The Government also proposes to

enable OFT to delegate the execution of its powers of investigation to local Trading Standards Officers.

- 10.10 Licensing credit information services:** businesses which on behalf of customers investigate, advise on, or take steps to amend records held by credit reference agencies or other credit businesses will in future need a consumer credit licence.
- 10.11 Independent tribunal:** The Bill will bring the licensing system into line with the latest best practice for appeals, by removing the appeal panel's link with the Secretary of State and establishing an independent tribunal.
- 10.12 Disapplication of s.101:** The Bill will extend the existing power of the OFT to disapply the right of hirers under s101 of the 1974 Act to terminate such agreements after 18 months in relation to specific hire agreements, to specified types of hire agreements. The OFT will only be able to use the power where it would be in the interests of hirers to do so. This will in particular make provision to reduce the administrative burden on the OFT so as to facilitate the further development of the government sponsored Home Computer Initiative and similar schemes.
- 10.13 Annual statements:** Consumer credit businesses will be required to issue annual statements for all fixed-sum credit accounts with a term of more than 12 months. The form and content of the annual statement will be prescribed in secondary legislation. The statement will contain specific information detailing what has happened over the account during the previous 12 months¹⁹ and some general information about debt advice and the resolution of any complaints.
- 10.14 Fees and charges:** Consumer credit businesses will be required to provide information about the fees and charges that are applied to an account for example when it is in arrears or default. All consumer credit businesses will be required to provide debtors with information setting out the fees and charges that are applied to the account.²⁰ The timing of such notices will depend on the level of fees and charges applied to the account. The consumer credit business will be required to provide the debtor with 28 days to pay the notified fees and charges before interest can be applied to them. Furthermore, consumer credit businesses will be prevented from being entitled to enforce the agreement until such

¹⁹ For the first statement only, this may, of course, cover a period of less than 12 months if the consumer credit business has specified a certain date which is less than 12 months from when the agreement was concluded or the credit advanced.

²⁰ The required information should be provided within 6 months of the charge or charges being applied to account. The required information may be set out in a stand-alone notice or be incorporated into another form of notice under the Act (such as an annual statement or a notice of arrears). However, if the charge or charges exceed a certain prescribed amount in a given month the required information must be provided within 1 month of the charge being applied to the individual's account. The Department would wish to prescribe a figure by secondary legislation to ensure that the requirement only captured significant charges being applied to an account rather than smaller regular charges.

time as they have complied with the notification requirements and will be prohibited from compounding any interest that is applied to default fees or charges (ie only simple interest will be permitted).

- 10.15 Running account statements:** The Government does not propose to make any changes to s.78(4) of the Act in respect of the consumer credit business's duty to provide periodic statements for running-account credit. However there will be a requirement for the content of running account statements to include a generic warning about the potential effect of making only minimum payments.
- 10.16 Arrears notices:** Consumer credit and hire businesses will be required to issue an arrears notice 14 days after an account goes into arrears. Arrears will be defined by reference to a failure to make a specified number of contracted repayments and provision will be made for short-term credit with high-frequency repayments. The form and content of the arrears notice will be prescribed in secondary legislation, and will include information about the arrears, any fees and charges payable. The notice will also be required to attach an OFT information sheet on arrears, which will include information about the options available to the defaulter or hirer, including time orders.
- 10.17 Default notices:** Sections 87 and 88 of the Act provide for a default notice to be served on the individual before the consumer credit or hire business is entitled to take further action. The form and content of such notices is prescribed by regulations²¹ made under s.88 of the Act. A consumer credit business will be required to include additional information in the default notice.
- 10.18 Post-judgment interest:** Consumer credit or hire businesses will be required to give notice that they are charging post-judgment interest. They will be required to provide a notice after judgment stating that they intend to claim interest, and 6 monthly notices thereafter. The notice will include information about the rate and amount of interest charged. If a consumer credit or hire business fails to provide a notice it will not be entitled to levy the interest. If, not having previously done so, the business decides that it wishes to claim such interest, it may do so, providing that it gives notice and provides the 6-monthly notices. It will not be entitled to claim interest from the period before it gave notice.
- 10.19 OFT Information Sheets:** OFT will be required to publish two specific information sheets that would be provided by the consumer credit business to the debtor when it issues:
- (a) an arrears notice, or
 - (b) a default notice.

²¹ Consumer Credit (Enforcement, Default and Termination Notices) Regulations 1983 SI 1983/1561

OFT will be able to determine the details of the information sheet and how the information is presented. The information required to be included in the information sheets will be set out in secondary legislation, including information about debt advice, complaints resolution, the availability of time orders and the possibility that further charges may be incurred in rescheduling payments.

- 10.20 Time Orders:** Section 129 of the Act will be amended to allow a debtor to seek a time order when they receive an arrears notice, not only at the stage where a notice of default is served, as is the case under the existing Act. The debtor will only be able to make the application once he or she has notified the lender of his or her intention to seek a time order and made an offer for the restructuring of payments to the consumer credit business. If the debtor and creditor cannot reach an agreement within 14 days, the debtor may make an application to the court for a time order. Furthermore, in Scotland, the court may permit debtors to be represented in applications relating to time orders by a suitably qualified layperson and not a solicitor or barrister.

Appropriate regulation of different types of consumer credit transactions

- 10.21 Abolition of the financial limit:** The Bill will abolish the existing financial limit above which Act regulation does not apply.
- 10.22 Exemption for most business lending:** All credit provided to businesses will be exempt from Act regulation, other than in relation to credit of a value of less than £25,000 provided to sole traders, partnerships of 3 or fewer partners and unincorporated associations.
- 10.23 Opt out for specific classes of consumers:** High net worth individuals who meet specific requirements in terms of their annual income or net assets will be entitled to opt out of regulation under the Act for consumer credit on the making of a declaration that they agree to forgo the protection of the Act.
- 10.24 Abolition of automatic unenforceability in relation to non-compliance with the technical requirements of the Act:** To abolish the requirement in s.127(3) of the Act that means that consumer credit agreements that do not comply with prescribed requirements of the Act are automatically unenforceable and to allow the court to determine the enforceability of all or part of the agreement according to its discretion.
- 10.25 Abolition of automatic unenforceability in relation to non-provision of information about cancellation:** To remove the requirement in s.127(4) of the Act that a failure to provide a cancellation notice in the terms required by the Act means that agreements are automatically unenforceable and to allow the court to determine

the enforceability of all or part of the agreement according to its discretion.

The regulatory impact of our reform proposals

11. Introduction

11.1 This section sets out an overview of the regulatory impact of the reform package set out in the Bill. It draws on the specific RIAs set out in the second part of this document. This section contains overviews of the reform package in respect of:

- (a) potential consumer benefits;
- (b) costs for a typical business;
- (c) business sectors affected;
- (d) issues of equity and fairness;
- (e) consultation with small businesses: the Small Firms Impact Test;
- (f) competition assessment;
- (g) enforcement and sanctions;
- (h) monitoring and review;
- (i) consultation.

The final section of this part sets out a summary and our recommendations.

12. Potential Consumer Benefits

12.1 In addition to reducing consumer detriment, which is not readily quantifiable, our proposed reforms can provide consumer benefits. The provision of clearer pre-contractual information²² will allow consumers (should they wish) to shop around and potentially achieve a better deal prior to entering into the agreement.²³ The provision of additional post-contractual information as proposed in the Bill may encourage consumers to switch to cheaper products. The provision of clearer post-contract information is expected to be directly attributable to £153 million of consumer savings a year.²⁴

13. Costs for a typical business:

²² as required by the Consumer Credit Regulations made in June and October 2004.

²³ See the RIAs for each of the Consumer Credit Regulations made in June and October 2004. These may be found at http://www.dti.gov.uk/ccp/topics1/consumer_finance.htm#review.

²⁴ It has been estimated that consumers could save £1.9 billion a year in interest payments alone, by switching to cheaper credit cards. This is based on the £52 billion outstanding credit card debt moving from the average interest rate of 15.3% to the average of the lowest quarter of 11.7%. (A similar exercise by Which? in June 2002 also estimated this saving to be in the region of £2 billion). Assuming similar relative savings can be made across all unsecured borrowing, we predict that if just 5% of borrowers switch to cheaper loans and credit cards this will generate a consumer benefit of £306 million a year. This benefit is generated by a combination of policy reforms; new rules in relation to post-contractual information are assumed to generate half of this benefit.

13.1 The proposed reforms are part of a wider consumer credit reform package, and consumer credit businesses will be required to absorb not only the costs of these reforms, but also the costs of compliance with the new Regulations in relation to pre-contractual disclosure, advertising, form and content of agreements and early settlement.²⁵

The cost of compliance

13.2 The proposed reforms mean that a typical consumer credit business will incur:

- (a) the following direct costs:
 - (i) compliance with the requirements of strengthened licensing system, including the payment of a 5-yearly licence fee and an ADR levy; and
 - (ii) provision to consumers of required post-contractual information (such as annual statements) in respect of regulated, non-exempt agreements; and
- (b) indirect costs, in respect of training staff and maintaining and auditing systems to ensure ongoing compliance with the Act.

Direct compliance costs for individual businesses

13.3 Direct costs will represent an incremental increase to existing costs to business. Licensing fees and the ADR levy will be a fixed cost for business. The cost of providing additional statements will vary depending on the nature of the business concerned and how much post-contractual information it presently provides to consumers.

- (a) ***licensing fees and the ADR levy:***
 - (i) ***costs for a sole trader*** – Forty percent of consumer credit licensees are sole traders. We estimate that the typical sole trader, will have additional direct compliance costs of c.£30-50 per year;²⁶ and
 - (ii) ***costs for other businesses*** - We estimate that other businesses will have additional direct compliance costs of c.£55-85 per year per consumer credit licence.²⁷

²⁵ These costs are set out in RIAs for each of the Consumer Credit Regulations made in June and October 2004. These may be found at http://www.dti.gov.uk/ccp/topics1/consumer_finance.htm#review.

²⁶ Made up of a £10-£20 ADR levy (source: FOS. The final amount of the levy has not been determined. FOS already covers a small number of consumer credit licensees. They will not be required to pay the ADR levy) and a 80-120% increase to the current 5-yearly licence fee of c.£110, giving a yearly increase of c.£18-26 per licensee. This is based on the current standard licence fee for sole traders bodies. OFT will be empowered to vary licence fees according to the size of business and the activities for which it is licensed.

²⁷ Made up of a £10-£20 ADR levy (source: FOS. The final amount of the levy has not been determined. FOS already covers a small number of consumer credit licensees. They will not be required to pay the ADR levy) and a 80-120% increase to the current 5-yearly licence fee of c.£275, giving a yearly increase of c.£44-66 per licensee. This is based on the current standard licence fee for incorporated bodies. OFT will be empowered to vary licence fees according to the size of business and the activities for which it is licensed.

- (b) ***provision of required post-contractual information:*** These requirements will affect only those consumer credit businesses that are lenders, which form less than 5% of consumer credit licensees. It is difficult to estimate the actual cost to lenders of these requirements, as it is highly dependent on the state of the lender's existing systems. Having said that, we estimate that the cost to a business of complying with the proposals on post contract transparency will be considerably less than the cost of complying with the requirements for pre-contract disclosure and form and content.²⁸ For example, if these costs are estimated to be only 20% of the cost of complying with the requirements for pre-contract disclosure, then the average cost to a business of complying with the proposed post-contract disclosure requirements is between £1,000 and £20,000. (We have estimated below the costs to fall within the range 10% -50% of the costs of compliance with the pre-contract disclosure requirements).
- (c) ***ongoing costs to business:*** The primary ongoing cost to business will be in respect of the provision of the annual statement. As we have said, this will be an incremental cost to most of those businesses required to provide these statements, as many already provide this information to consumers in some form. Other notices will apply in relation to situations of arrears and default, both of which are highly dependent on the nature of the lender's business.

Total direct compliance costs for all businesses

13.4 Based on the current number of active consumer credit licences, we estimate that the total additional direct cost of compliance with the ADR levy and the licensing regime will be:

- (a) c.£1.2 - £2 million per year for all sole traders;²⁹ and
(b) c.£3.5 - £5.5 million per year for other businesses.³⁰

giving a total additional cost of direct compliance to business of c.£4.7 - £7.5 million per year. This amount will be in addition to the c.£6 million currently paid annually to OFT by consumer credit businesses.

13.5 We estimate that the cost to small business of introducing the new post-contract information requirements would be a one-off cost to all small businesses c.£0.5 - 3 million.³¹ We estimate that the cost

²⁸ as required by the new Consumer Credit Regulations made in June and October 2004.

²⁹ Based on 40% of 106,000 active consumer credit licences (c.42,000) multiplied by £28-46.

³⁰ Based on 60% of 106,000 active consumer credit licences (c.64,000) multiplied by £54-86. This is based on the current unincorporated body licence fee of £275. Under the reforms, OFT will have the power to vary licence fees according to the size of the applicant or licensee's business or the activities it undertakes.

³¹ This estimate is based on the figures used in the RIAs relating to the form and content of agreements. In those RIAs we estimated that of the estimated cost to a small business of rewriting its agreements of £5,000.

of introducing the new post-contract information requirements would be a one-off cost to other businesses of c.£16 - £79 million.³²

Indirect compliance costs for business

13.6 For those businesses with compliance and complaint handling systems already in place, indirect costs may represent an incremental increase and an additional cost for those that do not. These costs will depend on the individual circumstances of each business and do not necessarily require considerable expenditure to develop and maintain.

13.7 All businesses that are members of a consumer credit trade association and other codes of practice should already have compliance and complaint handling systems in place. Indeed, costs associated with compliance and complaints handling reflect the degree of complexity of the business, and so costs for small businesses should be small. Larger businesses generally have such systems in place, and so costs will be incremental and not significant.

The cost of alleged non-compliance

13.8 If a consumer credit business is the subject of:

- (a) OFT action in relation to licensing issues; or
- (b) a complaint that leads to redress action by a consumer,

then the business may incur one or more of the following costs:

- (i) the cost of dealing with OFT requests for additional information;
- (ii) legal fees and other associated costs in respect of OFT licensing proceedings;
- (iii) a financial penalty, if the business breaches a licence requirement;
- (iv) an ADR case fee, if the consumer redress action is dealt with by ADR;³³

We estimate that the cost of developing new post-contract information will be 10% - 50% of that cost, or £500 - £2,500, bearing in mind that this requires the introduction of 4 standard notices –relating to annual statements, arrears notices, the notice relating to fees and charges and notices in relation to post-judgment interest. We estimate, based on the MORI survey of consumer credit licences conducted for DTI, that 5% of licensees are lenders (i.e. 5,000) and 22% of lenders are small businesses (i.e. 1,100).

³² This estimate is based on the figures used in the RIAs relating to the form and content of agreements. In those RIAs we estimated that of the estimated cost to a intermediate business of rewriting its agreements of £25,000 and to a large business £100,000. We estimate that the cost of developing new post-contract information will be 10% - 50% of those costs, or £2,500 - £12,500 and £10,000 - £50,000, bearing in mind that this requires the introduction of 4 standard notices –relating to annual statements, arrears notices, the notice relating to fees and charges and notices in relation to post-judgment interest. We estimate, based on the MORI survey of consumer credit licences conducted for DTI, that 5% of licensees are lenders (i.e. 5,000) and 78% of lenders are not small businesses (i.e. 3,900). Of these, we estimate that 80% are intermediate businesses (i.e. 3,100). Therefore, the cost to intermediate businesses would total c.£7.8 - £38.8 million and the cost to large businesses will be c.£8 - £40 million.

³³ The first two complaints to FOS will be free to the consumer credit business.

- (v) court costs, legal fees and other associated costs, if the consumer redress action is dealt with by a court;
- (vi) compensation payments, if a consumer claim is upheld against the business by either the ADR adjudicator or the court.

14. Business sectors affected:

14.1 The consumer credit market is diverse. Consumer credit businesses include banks, home credit companies, mail order companies, those providing credit for goods, credit cards, store cards, cheque cashers, debt collectors, financial advisers and credit brokers. Consumer credit products can include secured property loans, secured and unsecured lending for goods and services, overdrafts, running account credit and short-term cash loans. The nature of a consumer credit business will also depend on the circumstances of the consumers targeted – as this will dictate the types of credit products available to them.

The effect on business of the cost of compliance

14.2 All business sectors in the consumer credit market will incur costs of complying with the requirements of the Act. The direct costs of compliance with the licensing regime apply to all consumer credit businesses (albeit at varying levels of expense) and in most cases will represent an incremental increase to current costs of compliance (although credit information service providers and debt administration businesses, who do not currently require a licence, will face this new cost).³⁴ Costs in relation to post-contractual disclosure will be incurred by lenders and not by intermediaries.

The effect on business of the costs of alleged non-compliance

14.3 As we have stated above, the vast majority of businesses comply with the requirements of the Act and will comply with the reformed Act. However, some business sectors may be more exposed to costs of alleged non-compliance than others.

14.4 The potential for redress action will largely be confined to lenders and finance brokers (as opposed to other types of licensee, such as intermediaries), as non-compliance by these businesses is the most likely source of significant harm to consumers in respect of credit. Furthermore, the potential for redress action may be increased where consumers are more vulnerable to unfairness or exploitation in a particular sector.

14.5 The vast majority of businesses **are** compliant and are able to deal effectively with complaints internally, and will not have to incur

³⁴ Following consultation with the industry working group on credit repair, we estimate that there are up to 100 such businesses who will need a licence, of which some may already have a licence, if they also undertake other licensable business, such as debt-counselling.

these costs. Having said that, the costs associated with issues dealt with by ADR should be significantly less than those dealt with by traditional court means, reflecting the simpler process and the absence of legal fees and related costs.

15. Issues of equity and fairness

15.1 The proposed reforms are not intended to affect any particular sector of the consumer credit market more than any other. All consumer credit businesses will incur incrementally higher direct and indirect compliance costs, but we do not think that these will be significant.³⁵ The reforms are intended to ensure that all consumer credit businesses act according to consistent rules and standards of conduct in the operation of their businesses and in relation to the provision of credit to consumers.

15.2 Having said that, the reforms are designed to improve the position of those consumers who are vulnerable to exploitation when they obtain credit due to personal and situational factors. In some sectors of the market the degree of consumer vulnerability to unfairness and exploitation is higher, because of the types of consumers served by that sector and the manner in which lenders have lent historically. Those consumer credit businesses that participate in such sectors could have a higher risk of incurring the costs associated with alleged non-compliance.

16. Consultation with small businesses: the Small Firms Impact Test

16.1 The consumer credit industry involves many small firms: 40% of all licensees are sole traders, and 55% of all licensees employ less than 10 people.³⁶ Furthermore, the vast majority of these businesses are not lenders, but they provide ancillary credit services. We have consulted, and continue to work with trade associations representing small firms and their members (see consultation section below). We aim to avoid undue burdens on small business, and are balancing the costs of the reforms with the benefits of consumer protection.

16.2 We have conducted extensive consultation with small firms. We conducted a series of outreach sessions early in 2004 with representatives of small consumer credit businesses in Belfast, Cardiff, Glasgow and Manchester. DTI representatives have also met with and spoken to conferences held by the main UK trade associations representing small lenders – the Consumer Credit Association, the British Cheque Cashers Association and the National Pawnbrokers Association and also at a forum arranged by the Consumer Credit Trade Association.

³⁵ Though, as noted above, previously unlicensed credit information service providers would incur the costs of complying with the licensing regime for the first time.

³⁶ Source: MORI research on consumer credit licensees

- 16.3 Small firms have expressed some concern over the costs of compliance with the reformed Act. In preparing the reforms we have taken steps to reduce the regulatory burden on small firms by:
- (a) permitting licence fees to be varied according to categories (types of licensable business undertaken) and the number of categories covered by the licence;
 - (b) enabling OFT to distinguish between categories of consumer credit business according to the potential risk to consumers of activities in that sector, and to accommodate the particular circumstances of that sector;
 - (c) ensuring that the first two complaints handled by ADR will not require the payment of a case fee; and
 - (d) imposing less onerous requirements in relation to post-contract disclosure to take account of the lending of small sums over short periods, which is a sector in which small firms predominate.

17. Competition Assessment

- 17.1 The consumer credit market is a substantial and diverse one. The industry includes banks, home credit companies, mail order companies, those providing credit for goods, credit cards, store cards, cheque cashers, credit brokers and many more businesses, and who have current outstanding loans to consumers valued at c.£1 trillion, of which more than 80% is mortgage lending (now regulated by FSA). It is characterised by strong competition – the UK consumer credit market is often cited as the most developed in Europe – and no single firm has more than a 10% share of the market.
- 17.2 As described above in the “Business sectors affected” section, the costs of the proposals will not fall on any particular sector or firm, though businesses that lend money are likely to face higher costs than credit intermediaries because they will have to comply with the requirements on post-contractual disclosure, which intermediaries will not face. The level of costs associated with compliance with the licensing regime might also be higher for categories of consumer credit business identified in OFT’s guidance on licensing as posing a higher risk of detriment to consumers.
- 17.3 We do not expect that any of these costs are so significant as to pose a barrier to entry into the market. The few consumer credit businesses that have exploited weaknesses in the current regulation to act unscrupulously might decide to exit the market rather than incur the costs of adhering to the new regulations. That outcome is positive as it would exclude unfair traders from the

market, and the high number of firms in the consumer credit market means that their competitors could take on their business without negative effects on competition.

- 17.4 Indeed, we expect that the proposals will lead to higher standards of behaviour in the market, and thereby stimulate demand and encourage more vigorous and effective competition in the market. This will benefit consumers who will enjoy higher standards in the business and might experience more choice of fair traders, and will also benefit legitimate consumer credit businesses.³⁷

18. Enforcement and Sanctions

- 18.1 At present the Act provides few realistic enforcement and sanctions options. OFT cannot do anything other than seek to revoke, vary or suspend the licence of a non-compliant consumer credit business, and has few powers to compel consumer credit businesses to assist with its investigations. This means that enforcement of a type that does not relate to the most serious conduct is generally very difficult. Likewise consumers have few options available to them beyond the complaint and ADR systems maintained by consumer credit trade bodies (which we acknowledge to be effective in specific instances). The only other option is court action, which is expensive and intimidating for many consumers.

- 18.2 With these reforms, the Government seeks to do two things:

- (a) to encourage effective private enforcement of consumer rights with direct recovery of compensation from consumer credit businesses who act contrary to the requirements of the Act. This means that consumer credit businesses will be regulated by their own customers, on whom they depend; and
- (b) provide for better targeted and more proportionate public enforcement, which enables specific lenders and sectors to be targeted by OFT (and by Trading Standards Departments at local level), and for proportionate sanctions, including licence requirements.

- 18.3 By making these changes, we intend to ensure that enforcement and sanctions can be addressed to all significant problems that arise under the Act, and not to only the most extreme.

³⁷ In addition to this there are currently investigations being undertaken in respect of specific areas – by the Competition Commission in respect of store card lending, and by OFT in respect of home credit (which may be referred to the Competition Commission for a full inquiry).

19. Monitoring and Review

- 19.1 We intend to review the success of the changes introduced by assessing whether:
- (a) the causes for justified complaint by consumers have diminished;
 - (b) those complaints that are made are handled better by consumer credit businesses;
 - (c) the costs borne by consumer credit businesses are commensurate with the benefits that have accrued;
 - (d) regulators are more successful in addressing issues of unfair or illegal practices.
- 19.2 We will use both qualitative and quantitative measures to assess success. Qualitative measures will include the views of stakeholders in both industry and advisory groups and amongst the legal profession. Quantitative measure will include the collection of statistics on consumer enquiries and complaints to Consumer Direct and other advice providers with subsequent follow-up surveys to assess the outcome of enquiries and complaints.
- 19.3 Initial surveys will be carried out in the period between Royal Assent and commencement to provide a base point for comparisons in a review two years after commencement, alongside the review of the effectiveness of the other measures undertaken as a result of the current review of consumer legislation.

20. Consultation

Within government:

- 20.1 We have consulted the following bodies in relation to the proposed reforms to the Act:
- (a) **Central Government:** HM Treasury, Department for Constitutional Affairs and the Home Office; and
 - (b) **Devolved Government:** Scottish Executive, Scottish Courts Service, Welsh Assembly Government, Department of Enterprise, Trade & Industry, Northern Ireland, Northern Ireland Courts Service and Equality Commission of Northern Ireland.
 - (c) **Local Government:** Local Authorities Co-ordinators of Regulatory Services (LACORS).
 - (d) **Public bodies:** Office of Fair Trading, Financial Ombudsman Service, Financial Services Authority, Office of the

Information Commissioner and the Law Commission of
England & Wales.

Public consultation:

- 20.2 We have undertaken the following public consultation in addition to that conducted preliminary to the White Paper:
- (a) **Consultation papers:**
 - (i) consultation on issues discussed in the White Paper – “Fair, Clear and Competitive – The consumer credit market in the 21st century”, published on 8 December 2003; and
 - (ii) ‘The Provision of Alternative Dispute Resolution for Disputes Arising under the Act’, published on 17 December 2003. We received over 40 responses, and a response to this consultation been published. Over 80% of respondents identified FOS as their choice of provider for consumer credit ADR.
 - (b) there has also been extensive informal consultation with trade associations, advice providers, consumer groups and legal representatives. These include:
 - (i) British Bankers Association, British Cheque Cashers Association, Consumer Credit Association (UK), Consumer Credit Trade Association, Council of Mortgage Lenders, Finance & Leasing Association, Finance Industry Standards Association, Mail Order Traders Association, National Association of Pawnbrokers; and individual small lenders at a series of meetings in Manchester, Cardiff, Glasgow, and Belfast;
 - (ii) National Consumer Council, General Consumer Council of Northern Ireland, Citizens Advice (England & Wales), Citizens Advice Scotland, Money Advice Trust, Money Advice Association, Money Advice Scotland, Advice UK, Consumer Credit Counselling Service, Debt on our Doorstep (Church Action on Poverty);
 - (iii) Trading Standards Institute, Scottish Trading Standards Institute, Local Government Association;
 - (iv) Association of District Judges and Sheriffs Association;
 - (v) representatives of overseas government bodies concerned with consumer credit issues, including:
 - (A) Consumer & Corporate Regulation Division of the Department of Trade & Industry and the

Micro-Finance Regulatory Council, Republic of South Africa;

- (B) Consumer & Business Affairs, Department of Justice, Victoria, Australia;
- (C) Office of Fair Trading, New South Wales, Australia; and
- (D) Ministry of Consumer Affairs, New Zealand.

Summary and Recommendations

21. Improving consumer rights and redress

Option	Cost	Benefit
1: Do nothing	No additional costs	No additional benefits
2: Reform extortionate credit test and introduce a compulsory ADR	<p>Total cost of the ADR levy – c.£1-2 million.</p> <p>Costs for business in complying with complaints handling standards, dealing with additional complaints and the ADR process.</p> <p>Lenders will face the cost of transferring to consumers the money they had gained as a consequence of unfairness.</p> <p>A larger number of consumers will incur costs in pursuing complaints.</p> <p>Advice providers may face costs in bringing more complaints to ADR and the courts, in training staff and educating consumers.</p>	<p>New test of unfairness and the opportunity for consumers to go to ADR will improve conduct of lenders in the market, thereby reducing consumer detriment in the market that currently amounts to hundreds of millions of pounds.</p> <p>Reduction in costs to each individual consumer of making complaints.</p> <p>Consumers will benefit from a transfer from lenders of the money paid to lenders as a consequence of unfairness.</p> <p>Effective competition in the market will be improved.</p> <p>Reduce costs to business of dealing with complaints by enabling them to be dealt with by non-legal means.</p>
3: Voluntary code	<p>The costs for businesses would be about half of those for option 2.</p> <p>Consumer detriment would also be higher than under option 2, and reduced only slightly from the current situation.</p>	<p>Benefits would be similar to those derived under option 2, but of a smaller magnitude since they would only be felt by clients of those businesses who had signed up to the code. We estimate that the benefits would be around half of those under option 2.</p>

22. Improving regulation of the consumer credit businesses

Option	Cost	Benefit
1: Do Nothing	No additional costs	No additional benefits
2: Deregulate	<p>Increased consumer detriment as unfit businesses would be able to enter the market. Current estimates are that consumer detriment amounts to hundreds of millions of pounds: with no regulation, this will increase.</p> <p>Increased burden on Alternative Dispute Resolution mechanism with complaints rising by estimated 10-25% per year, costing between £500,000 and £1.5m a year.</p> <p>Increased cost of using ADR (higher case fee) because no mechanism for levy via licensing regime.</p> <p>Loss of consumer confidence in the market</p> <p>OFT loses information about traders to target guidance.</p>	<p>Abolition of licensing regime saves business licence fees of around £6m per year, and administration costs of between £120,000 and £240,000 per year.</p> <p>Saves OFT around £6m per year running costs of licensing regime.</p> <p>No benefits for consumers.</p>
3: Strengthen regulatory regime	<p>Licensing fees expected approximately to double, so increased cost for business of up to £5.5m (funding OFT's operation of the enhanced licensing system).</p> <p>Costs for business of provision of extra information to OFT where this is needed due to the risk assessment or concerns over fitness.</p>	<p>Fewer unfit consumer credit businesses in the market, thereby reducing consumer detriment, both in the consumer credit market (current detriment estimated at hundreds of millions of pounds) and in other connected markets (overall consumer detriment in the economy estimated as over £8bn).</p> <p>Indefinite licences reduce</p>

	<p>Costs of becoming licensed and compliance for previously unlicensed credit information services or debt administration businesses.</p> <p>Implementation costs for OFT of around £500,000 for the new licensing regime, and costs of producing Information sheets on arrears statements, notices, and time orders.</p> <p>Costs of post-contractual disclosure to business of £16-79 million.</p> <p>Costs of amendment of court forms of around £30,000.</p> <p>Costs to debtors of bringing time order applications of between £1.4m and £3.1m (though these costs may be recovered).</p>	<p>administrative costs for business after five-year transitional period, saving around £200,000.</p> <p>Better informed consumers are empowered to discuss problems with consumer credit businesses at an earlier stage and exercise their rights, reducing consumer detriment and saving business costs in writing off debts, providing an estimated saving to consumers of £153 million.</p> <p>After five-year transitional period, OFT costs of running licensing regime fall.</p> <p>Improve effective competition in the market.</p>
<p>4: Voluntary code</p>	<p>Unscrupulous businesses would not sign up to the code, so costs of consumer detriment (currently estimated as amounting to hundreds of millions of pounds) would increase.</p> <p>Compliance costs incurred by those who sign up to the code, so total cost lower than options 1 and 3.</p> <p>OFT and Code Sponsor would incur costs in establishing and raising awareness of code, estimated to be less than £1m.</p>	<p>Some increased consumer protection compared with no regulation, but benefits apply only to clients of businesses who have chosen to adopt the code.</p> <p>OFT would save over £5m compared with running the licensing regime.</p> <p>Businesses which did not adhere to the code (estimated to be the majority), would save licence fees and administration costs.</p>

23. Appropriate regulation of different types of consumer credit transactions

Option	Cost	Benefit
1. Do nothing	No additional cost	No additional benefit
2. Remove the financial limit and provide appropriate regulation	<p>Minor systems changes by business may be required when loans over £25,000 are covered by Act regulation.</p> <p>Some costs to business of devising and operating tests to identify business lending and identify High Net Worth customers.</p>	<p>Increased protection of consumers, regardless of the value of the transaction.</p> <p>Industry will benefit from removal of automatic unenforceability under s.127 to give greater certainty and removal of the risk of its opportunistic use.</p>
3. Raise the current financial limit	<p>Scope for considerable consumer detriment in relation to larger credit agreements, and confusion of the two-tier system.</p> <p>Further regulation would be required in accordance with inflation in future.</p> <p>Incremental cost to business of the application of early settlement rules to all non-exempt consumer credit agreements and voluntary termination rules to all non-exempt hire purchase agreements.</p>	<p>Would cover most consumer credit agreements by value and volume.</p> <p>Could be effected quickly by secondary legislation.</p>

24. Ministerial declaration:

"I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs".

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Gerry Sutcliffe MP

Parliamentary Under-Secretary of State for Employment Relations
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25. Contact:

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Part 2

Options for reform – Specific Regulatory Impact Assessments

Specific Regulatory Impact Assessment: Improving Consumer Rights and Redress

26. Title of the proposal

26.1 The amendment of the Act to improve the ability of consumers to challenge instances of unfairness and to resolve credit disputes.

27. Purpose and intended effect of the measure

The objective:

27.1 The proposals will better enable consumers to challenge unfairness in consumer credit relationships. We propose to replace the current ineffective 'extortionate' credit test with one concerned with 'unfairness' and which covers the entire consumer credit relationship. We also propose to introduce a compulsory alternative dispute resolution system (ADR) that will bind almost all consumer credit businesses.³⁸

27.2 We intend that these reforms will improve the ability of consumers to seek redress, make it easier for borrowers and consumer credit businesses to resolve disputes in a speedy, fair and proportionate manner, and act as an incentive to compliance with the procedural requirements of the Act and the enhanced licensing regime.

Background:

27.3 The Government has introduced new Regulations about pre-contract disclosure and early settlement to improve the quality of the information consumers receive from consumer credit businesses. The Government also wants to better enable consumers to challenge genuinely unfair credit agreements and obtain redress by the most appropriate means.

The problems with obtaining redress under the current law

27.4 Under the Act, a court may re-open a credit agreement to alter its terms or to set it aside where it is found to be part of an 'extortionate' credit bargain. Within the constraints imposed by issues of access to justice, this test has not served to enable consumers to seek effective redress. This means that consumers are unable and unwilling to challenge "extortionate" conduct by lenders and means that some unscrupulous lenders may persist with exploitative practices.

³⁸ ADR will not cover unlicensed businesses or those covered by group licences.

- 27.5 In the 27 years of the Act's operation, we understand that very few consumers have succeeded in having a court reopen a credit agreement on the basis that it is part of an extortionate credit bargain. There are only about 30 published court judgments that we are aware of where a court has considered the issue,³⁹ although we are aware that the issue has been raised in proceedings more frequently.⁴⁰
- 27.6 The poor utilisation of the test has been due to:
- (a) the narrow interpretation of the current test to mean that the assessment of whether a credit bargain is 'extortionate' is focussed on the terms of the agreement and the cost of credit;
 - (b) the current standard of "extortionate" is too high to effectively deter or sanction practices that are unfair or exploitative; and
 - (c) the difficulty for consumers in bringing claims to court. There are considerable impediments for consumers inherent in the civil justice system, such as expense, risk, and complexity,⁴¹ but an important factor has also been the 'extortionate' credit test's inability to address effectively many of the problems that actually confront consumers in terms of unfair lending practices.
- 27.7 There are also costs for consumers in obtaining information about their options for redress, and if the consumer assesses the cost of seeking redress to be higher than their associated detriment, then they may quite reasonably decide not to seek redress.⁴²
- 27.8 These factors restrict the effectiveness of the Act for consumers by inhibiting private enforcement, and also mean that those consumers who are particularly vulnerable to unfairness are more exposed to exploitation by unscrupulous consumer credit businesses.

³⁹ The DTI's review of the law reports and the transcripts of available judgments has found only 30 cases in which a court has determined the issue of whether a credit bargain is extortionate in the period 1977 to 2004. Of these, the consumer was successful in 11 cases; which is a rate of success that we regard to be much higher than would actually apply in respect of all cases involving an extortionate credit issue.

⁴⁰ The Department for Constitutional Affairs does not record specific statistics of cases that involve issues under the Act. The issue most often arises as part of a defence to proceedings commenced by a consumer credit business. The consumer's representatives would often raise extortionate credit as an issue in the course of informal negotiations.

⁴¹ Recent reports have emphasised that borrowers can also face practical, psychological and cultural barriers to bringing court action and that those who are particularly vulnerable will feel intimidated by the court process and/or fear the consumer credit business: see FSA 2002-03 Annual Report, p.211. Generally speaking, consumers cannot obtain legal aid for this type of civil claim.

⁴² Most consumer credit disputes consist of more than one element of complaint. Several elements are often interlinked and flow from each other, which can result in complex cases.

28. Risk Assessment:

28.1 Effective consumer redress is critical to the proper enforcement of a regulatory statute. It means that the law becomes better enforced, by:

- (a) allowing consumers to challenge unfair conduct by consumer credit businesses and to obtain direct redress; and
- (b) improving the effectiveness of regulators by allowing them to target specific problems (see specific RIA on licensing reform below).

Such a regime encourages consumer credit businesses to comply with the required standards of conduct, because they can be sanctioned not only by regulators, but also by the customers on whom they depend.

28.2 We have set out in Part 1 above an indication of the current extent of consumer detriment in the consumer credit market. While we cannot accurately quantify its full extent, it is considerable, and based on recent trends, increasing. A failure to reform the Act to allow for more effective consumer redress will allow the current situation to continue and potentially worsen.

29. Options

Option 1: Do nothing.

29.1 Make no changes to the Act, retaining the extortionate credit test, and leaving the courts as the only universally applicable form of dispute resolution.

Option 2: Reform the extortionate credit test and introduce a compulsory ADR system.

29.2 Replace the 'extortionate credit test' with a new test based on 'unfairness' and introduce a mandatory ADR regime for consumer credit.

Option 3: Introduce voluntary codes of practice with new standards of conduct and dispute resolution procedures.

29.3 Industry establishes OFT-approved voluntary codes of practice that specifically address the issue of unfairness in credit relationships and provide for ADR.⁴³

⁴³ We acknowledge here that there are a number of informal dispute resolution schemes run by trade associations that currently provide an option other than the courts for some consumer credit disputes. We envisage them continuing to play an important role in the overall dispute resolution picture. However, there are a number of reasons why we wish to introduce an additional system of ADR. Trade association schemes can only be used for disputes against members of the trade association, and many consumer credit businesses are not members of any association (see note 35 above). The existing schemes are effective but they are voluntary and are not universal in their application. Act and consumers can be wary of taking their dispute to an industry body whom they may perceive as being 'on the side of' the business about which they are complaining. An independent ADR scheme that covers all licensed consumer credit businesses is desirable.

30. Benefits

Option 1: Do nothing.

- 30.1 Option 1 would provide no additional benefits to consumers,⁴⁴ nor do we consider that it would provide any additional benefit to business as it would not serve to create a more efficient and competitive consumer credit market.

Option 2: Reform the extortionate credit test and introduce a compulsory ADR system.

- 30.2 Option 2 would provide the following benefits to consumers:
- (a) improve opportunities for consumers to seek redress by introducing:
 - (i) a test (i.e. that consumer credit businesses should not behave unfairly) which relates to the nature of the conduct of the consumer credit business at all times in the consumer credit relationship rather than an assessment of the terms of the agreement and whether they allow for extortionate costs; and
 - (ii) an ADR system which is binding on all licensed consumer credit businesses and allows consumers to have disputes determined by an independent adjudicator at no cost; and
 - (b) allow for direct recovery through the courts or ADR of the amounts paid by consumers to consumer credit businesses as a consequence of unfairness;
 - (c) allow for consumers to obtain relief against consumer credit businesses, whether in the form of changes to terms of the agreement or repayment schedules, an apology, additional services or compensation;
 - (d) improve lending practices by creating a regime that allows for direct consumer redress and direct recovery of the money paid to consumer credit businesses as a consequence of unfairness; and
 - (e) reduce the cost to consumers of making enquiries and making complaints.
- 30.3 Option 2 would provide the following benefits to those consumer credit businesses who do not behave unfairly:
- (a) create a more effective, efficient and competitive consumer credit market by facilitating the development of a general standard of conduct across all consumer credit businesses

⁴⁴ i.e. additional to those that flow from the introduction of the Regulations in relation to pre-contractual disclosure.

through a general test of unfairness and the compulsory application of ADR;

- (b) encourage greater consumer confidence, by creating a system which encourages and promotes better business behaviour; and
- (c) serve to reduce the cost to consumer credit businesses of dealing with consumer complaints through formal court processes by allowing for them to be dealt with by non-court means.

Option 3: Introduce voluntary codes of practice with new standards of conduct and dispute resolution procedures.

- 30.4 Generally speaking, those consumer credit businesses that have a code of practice are those that are members of trade associations. However, there are c.106,000 active consumer credit licensees⁴⁵ and, since the largest consumer credit trade associations have only several hundred members,⁴⁶ the vast majority of consumer credit businesses are not members of a consumer credit trade association (although they may be a member of another trade-based body),⁴⁷ and would therefore be less likely to sign up to a recommended code of practice published by a consumer credit trade association.
- 30.5 There may be an incentive for consumer credit businesses to join trade associations with a code of practice to signal to consumers that they are reputable, but equally some businesses may not want to be bound by a code's requirements and may leave their trade association. Assuming that these two effects approximately cancel out, voluntary codes based on trade association membership would not cover the majority of consumer credit businesses, and particularly those who provide activities ancillary to lending, such as brokerage and debt collection.
- 30.6 On this basis, we estimate that this option would provide about half of the benefits of Option 2, because it would only do so where consumer credit businesses have chosen to sign up and adhere to applicable codes of practice. It would also be limited because:

⁴⁵ Source: MORI research consumer credit licensees (commissioned by DTI in 2004). Of the 106,000 active consumer credit licensees, less than 5,000 are active credit providers.

⁴⁶ The Finance & Leasing Association has 188 members. The Consumer Credit Trade Association has 500 members. The Consumer Credit Association has 500 members. The British Bankers Association has 295 members. CML has 144 members. We acknowledge that these represent the bulk of active credit providers in the market. These businesses also represent the vast bulk of the consumer credit market in terms of money lent. Some consumer credit businesses will have memberships in several such organizations and not all will offer Act-regulated loans.

⁴⁷ Many of these providers may be members of other trade associations more directly linked with their field of business (e.g. a motor vehicle dealer which offers finance as part of their service, may not be a member of a consumer credit trade association but a motor vehicle trade association).

- (a) those consumer credit businesses who are least likely to comply with the law are most likely not to sign up to applicable codes of practice; and
- (b) inconsistencies between codes of practice lead to different levels of consumer protection and reduced transparency for consumers.

31. Costs

Option 1: Do nothing.

- 31.1 Option 1 would not impose any additional costs on business. Consumer detriment resulting from the current situation would continue.

Option 2: Reform the extortionate credit test and introduce a compulsory ADR system.

- 31.2 Replacing the 'extortionate' credit test and introducing a compulsory ADR system would mean that all consumer credit businesses would be required to pay for the scheme, through a levy. This levy would be modest and would cover the basic administration costs of the scheme. It is estimated to cost between £10-£20 per licence.
- 31.3 Consumer credit businesses could also incur some indirect costs in terms of modifying or improving existing compliance and complaint handling systems. For many consumer credit businesses these costs will represent an incremental increase, although some will incur additional costs in developing these systems.
- 31.4 Option 2 would also mean that consumer credit businesses could incur indirect costs, arising out of alleged non-compliance with the reformed Act. Not all businesses would incur such costs, as the vast majority is compliant. These indirect costs could include:
- (a) a system which facilitates consumer enquiries and complaints will mean that consumer credit businesses:
 - (i) could be required to dedicate additional resources to complaint handling; and
 - (ii) would be required to meet specific complaints handling standards, which is a consequence of the requirement for consumer credit businesses to submit to ADR;⁴⁸ and
 - (iii) the potential for an impact on loan securitisation markets, which are used by lenders in some sectors of

⁴⁸ We propose that submitting to ADR will be a mandatory condition of fitness to hold a consumer credit licence, and that FOS will require standards similar to those required by FSA - in respect of complaint handling systems.

the credit market⁴⁹ as a means of generating funding. The indirect cost implication for lenders would be caused by an increase in the risk to lenders, particularly in the more marginal sectors of the market, of challenge by consumers. However, such a risk only applies to those lenders who do not comply with the requirements for the reformed Act (and, in some cases, with the requirements of the current legislation), and so this is a potential cost which arises only as a result of non-compliance.⁵⁰

- (b) in cases that are determined by ADR, those consumer credit businesses which are found to have acted in a manner which is not 'fair and reasonable' could face the possibility of compensating consumers, e.g. changes to terms of the agreement or repayment schedules, an apology, additional services or financial compensation (this will represent a direct transfer from business to consumers);
- (c) in cases determined by courts under the unfair credit test, consumer credit businesses who are found to have behaved 'unfairly' could face the possibility of compensating consumers, e.g. changes to terms of the agreement or repayment schedules, financial compensation and the payment of legal costs (this will represent a direct transfer from business to consumers) ; and
- (d) as a consequence of a regime that encourages a general standard of conduct, consumer credit businesses will incur costs in ensuring internal compliance with the Act, in terms of training staff and auditing systems.

31.5 Replacing the 'extortionate' credit test and introducing a compulsory ADR system would result in the following costs to consumers:

- (a) an improved ability to seek and obtain redress may encourage more consumers to do so. This will mean that more consumers will incur costs in making those enquiries both to consumer credit businesses and to the ADR provider (although those who are successful may receive compensation and offset these costs);
- (b) advice providers could also incur additional costs in:

⁴⁹ Notably the markets for second charge mortgages, credit card finance and some motor finance.

⁵⁰ DTI has discussed this issue with lender representative bodies and ratings agencies. While a risk exists as a consequence of challenges being easier to make, the implications for the securitisation market are mitigated by the existence of the transitional period before which the new test will not apply to existing loans (see Schedule 3 of the Bill), which may be further extended in respect of particular categories of loan. The current low risk of challenge is not derived from compliance so much as from a legal situation that does not permit debtors to effectively challenge unfair conduct by lenders. As a consequence of the decision in *Meadows & Anor v. London North Securities* it could also be said that the risk of challenge under the existing test has increased.

- (i) bringing a higher number of more effective complaints to ADR and to courts;
- (ii) training staff and educating consumers about the new options open to consumers.

31.6 There is also a possibility that in some sectors of the market the changes will mean that the cost of borrowing may increase slightly, to reflect the initial increase in the risk to consumer credit businesses of challenges. This could result in some costs being passed on to consumers. However, we anticipate that these costs will be negligible when considered over the whole consumer credit market, because business will also have significant incentives to comply with the reformed Act and thus reduce this risk.⁵¹

⁵¹ These costs should also be balanced against the increased certainty that lenders will enjoy as a consequence of the amendments to subs.127(3)& (4) Act; see para.53.4 below.

Option 3: Introduce voluntary codes of practice with new standards of conduct and dispute resolution procedures.

- 31.7 We estimate that this option would result in business incurring about half of the costs of Option 2, for the reasons set out in paragraphs 30.4-30.6 above.
- 31.8 It would also mean that consumers would continue to suffer a higher degree of detriment than they would under Option 2, because the level of consumer protection and rights of redress would be lower.

32. Our preferred option

- 32.1 On the basis of the benefit and cost analysis set out above and our consultations with stakeholders, our preferred option is Option 2: reform the extortionate credit test and introduce an ADR system.

33. Costs for a typical business

- 33.1 **The cost of compliance** – A typical consumer credit business would incur direct costs in relation to the payment of a levy to fund the ADR scheme⁵² and may incur indirect costs in relation to training staff and maintaining and auditing compliance with the reformed Act. Direct costs would represent an incremental cost to business. Indirect costs could represent an incremental cost to businesses where they already have complaints handling and compliance systems in place, and an additional cost for those that do not.
- 33.2 We estimate that all consumer credit licensees will incur additional direct compliance costs of between £10 and £20 per year for the ADR levy.
- 33.3 **The cost of alleged non-compliance** – If a consumer credit business is the subject of a complaint that leads to redress action by a consumer, then the business may incur one or more of the following costs:
- (a) an ADR case fee, if the consumer redress action is dealt with by ADR;
 - (b) court costs, legal fees and other associated management costs, if the consumer redress action is dealt with by a court; and
 - (c) compensation payments, if a consumer claim is upheld against the business by either the ADR adjudicator or the court.

These are the costs of alleged or actual non-compliance with the reformed Act. The vast majority of businesses **are** compliant and will remain so, and will not have to incur these costs. The scale of

⁵² FOS has estimated that the levy will be about £10-£20 per annum per business.

these costs will depend on the individual circumstances of the businesses concerned.

34. Business sectors affected

- 34.1 The effect of the cost of compliance** – All consumer credit businesses would incur the direct costs of the new ADR scheme, which we estimate will cost c.£1-2 million per year.⁵³ Those that do not now have any compliance and complaints handling systems or a sufficient system in place may incur an increase in indirect costs resulting from the changes. The costs of compliance will fall more heavily on those businesses with undeveloped or non-existent compliance and complaints handling systems.
- 34.2 The effect of the cost of alleged non-compliance** – As we have said above, the vast majority of businesses are compliant and will incur no costs associated with non-compliance. However, some business sectors may be more exposed to costs of alleged non-compliance than others. The potential for redress action will largely be confined to lenders and finance brokers, as non-compliance by these businesses is the most likely source of significant harm to consumers in respect of credit. Furthermore, the potential for redress action may increase where consumers are more vulnerable to unfairness or exploitation in a particular sector.

35. Issues of equity and fairness

- 35.1** The proposed reforms are not designed to affect any particular group of consumer credit businesses any more than any other. All consumer credit businesses will incur some costs, but the extent of these costs will depend on their current level of compliance. The reforms are intended to ensure that all consumer credit businesses act according to consistent rules and standards in respect of their dealings with consumers.
- 35.2** Having said that, the proposed reforms are designed to improve the position of those consumers who are vulnerable to exploitation when they obtain credit due to personal and situational factors. In some sectors of the market the degree of consumer vulnerability to exploitation and unfairness is higher, because of the types of consumers served by that sector and historical lending practices. Those consumer credit businesses that concentrate on these sectors could have a higher risk of incurring costs associated with alleged non-compliance.

36. Consultation with small business: the Small Firms Impact Test

- 36.1** The consumer credit industry involves many small firms: 40% of all licensees are sole traders, and 55% of all licensees employ less than 10 people.⁵⁴ We have consulted, and continue to work with

⁵³ Based on 106,000 active consumer credit licensees paying between £10 and £20 each.

⁵⁴ Source: MORI research on consumer credit licensees

trade associations representing small firms and their members (see 20.2 *Public Consultation* above). We aim to avoid undue burdens on small business, and balance the costs of the reforms with the benefits of consumer protection.

- 36.2 Small firms have expressed some concern over the costs of compliance with the reformed Act. They have also expressed concern that they will face high costs in relation to ADR, if there is a large number of cases brought by consumers. This risk will be mitigated by FOS's proposal to waive the case fee for the first two cases brought against a firm per year: small firms are unlikely to face many more than two cases, so they will not incur substantial costs.⁵⁵
- 36.3 If a business is the subject of a lot of cases in proportion to the level of its consumer credit activity then this could suggest non-compliance with the Act, and also leave it open to licensing action. The ADR mechanism will filter complaints carefully before taking them on as cases, to ensure that they are not frivolous or vexatious. Consumer credit businesses will also be assisted by OFT guidance on licensing and enforcement.

37. Enforcement and sanctions

- 37.1 At present the Act provides few realistic options for consumers to challenge unfair and exploitative conduct. Consumers have few options available to them beyond the complaint and ADR systems maintained by consumer credit trade bodies (which we acknowledge to be effective in specific instances).
- 37.2 The only other option is court action, which is expensive and off-putting for many consumers. With these reforms, the Government seeks to encourage effective private enforcement of consumer rights with direct recovery of compensation from consumer credit businesses who act contrary to the requirements of the Act. This means that customers will help to regulate consumer credit businesses.
- 37.3 By making these changes, we intend to ensure that enforcement and sanctions can be addressed to all significant problems that arise under the Act, and not to only the most extreme.

⁵⁵ Source: MORI research on consumer credit licensees: 93% of licensees receive two or fewer complaints.

***Specific Regulatory Impact Assessment:
Improving regulation of consumer credit businesses***

38. Title of proposal

- 38.1 The amendment of the Act to update the regulation of consumer credit businesses, including:
- (a) strengthening the consumer credit licensing regime,
 - (b) tightening requirements for disclosure of information post-contract, and
 - (c) bringing forward the time at which the consumer may apply for a time order.

39. Purpose and intended effect of measure

The Objective

- 39.1 The proposals are intended to enhance consumer protection by:
- (a) providing OFT with more effective powers to ensure that persons holding a consumer credit licence are fit to do so,
 - (b) providing consumers with clear information so they are aware of their financial obligations, and
 - (c) encouraging, by bringing forward the time at which a time order can be applied for, earlier discussion between consumers and lenders about the rescheduling of payments.
- 39.2 More effective regulation will also bring benefits to the vast majority of businesses who comply with the law as it will raise standards across the consumer credit industry and bring wider benefits by improving trading practices not directly connected with consumer credit, thereby enhancing consumer confidence.

Background

- 39.3 As described above, the Act's regulation of the consumer credit market suffers from some serious limitations. The current licensing regime provides a blunt tool for OFT to ensure consumer credit businesses are fit to hold a consumer credit licence. This means that it is not always possible for OFT to act against behaviour detrimental to consumers.
- 39.4 The Act also leaves gaps in the obligations it imposes on business in terms of the information that they must provide to consumers. This allows for a situation where, all too often, customers are surprised by significant arrears or default charges and can, in some instances have been the unwitting victims of unscrupulous business practices because of this lack of information. This type of unfit behaviour by consumer credit businesses creates

considerable consumer detriment.⁵⁶ We propose to provide OFT with effective tools to protect consumers.

40. Risk assessment

40.1 The risk of substantial consumer detriment arising from the weaknesses of the current regulatory regime is significant.

Licensing

40.2 We have set out in Part 1 above an indication of the scale of consumer detriment that results from the behaviour of consumer credit businesses. OFT, in enforcing the Act, is constrained in its ability under the licensing regime to address in a proportionate way trading practices giving rise to consumer detriment (i.e. behaviour which might not be sufficiently poor to mean that a business may be unfit to hold a licence). If allowed to persist, this could lead to consumers losing trust and confidence in the market and potentially damage the businesses of reputable traders.

40.3 We have identified the following weaknesses in the Act's licensing regime:

- (a) the current test of fitness is limited in that it is essentially backward looking, requiring OFT to give particular weight to past conduct, rather than looking forward and considering the competence of the business to provide credit and credit services. Since past behaviour is not always the best indicator of future behaviour, this may allow potentially unfit traders to enter the market;
- (b) it does not allow OFT to take a risk-based approach (including a "light touch" approach for low-risk businesses) and apply a more stringent approach where there are risks to consumers;
- (c) the sanctions available to OFT where the fitness of the applicant or consumer credit business is in doubt are not always adequate. At present, OFT may only refuse an application for a licence, grant a licence on different terms or revoke, vary or suspend a licence. For example, a consumer credit business may cause consumer detriment due to the activities of a small part of its business, but remain fit to hold a licence when the business is considered as a whole.

In such circumstances the sanctions available do not provide a suitable means of addressing the problem. Currently OFT licensing enforcement section receives c.3,000 to 4,000 complaints a year about consumer credit businesses, of which c.850 are deemed to merit opening an investigation which result in c.250 warning letters being issued. If OFT

⁵⁶ See Part 1 above.

wishes to take these cases further, its only option is to take formal action to suspend, vary or revoke the licence, which may not be proportionate, and serves as a disincentive to others to complain about problems. There is therefore potential for consumer detriment owing to the restrictions on the enforcement powers of OFT;

- (d) the information gathering powers of OFT are limited after a licence has been granted or where information is sought from third parties. This means that it is difficult for OFT effectively to monitor the ongoing fitness of consumer credit businesses. Furthermore, because of the limitations on OFT's ability to investigate and act, there is little incentive for bodies such as Trading Standards Departments ("TSDs") and others to refer complaints to OFT;
- (e) businesses which on behalf of customers investigate, advise on, or take steps to amend records held by credit reference agencies or other credit businesses are not required to have a licence. This means that OFT cannot use the licensing regime to deal with any concerns arising from the conduct of these firms, such as misleading consumers with regard to the services they can provide;⁵⁷ and
- (f) appeals against adverse licensing decisions are made to the Secretary of State for Trade & Industry, who appoints a panel of three persons to hear decisions on her behalf. This framework linking appeals to the Secretary of State does not accord with the need to ensure that such decisions are not, and are not seen to be, affected by political considerations.

Post-contractual information and time orders

- 40.4 Many of the problems encountered by consumers arise after the agreement is made and involve the escalation of their outstanding debt due to fees, charges and penalties being applied to the account. Commonly, such charges are applied to the account when it goes into arrears, and the consumer can remain ignorant about the effect of the accumulation of these charges.
- 40.5 Our studies of advice provider cases show that the difficulties consumers suffer in meeting their credit commitments often arise from not being aware of the potential full cost of the commitments entered into before and during the life of the agreement.

⁵⁷ See OFT's Consumer Alert "Credit Repair Promises Fall Short".

41. Options

Option 1: Do nothing.

- 41.1 Make no changes to the current licensing regime or the rules in relation to time orders and introduce no additional requirements in relation to post-contractual disclosure.

Option 2: Deregulation

- 41.2 Deregulate to abolish the licensing regime, making no changes to the current requirements on post-contractual disclosure and time orders.⁵⁸

Option 3: Proportionate Regulation

- 41.3 Strengthen the regulatory regime to make the fitness test more effective, enhance OFT's powers to monitor ongoing fitness, require improved post-contractual disclosure of information and enable consumers to seek time orders earlier.

Option 4: Voluntary Codes

- 41.4 Introduce a voluntary scheme, e.g. an OFT-approved voluntary code (or codes) of practice.⁵⁹

42. Benefits

Option 1: Do nothing.

- 42.1 This option would provide no additional benefits for consumers or business, and the only beneficiaries would be those consumer credit businesses who exploit the current limitations of the legislation, or do not provide proper disclosure to consumers or to OFT in relation to licensing.

Option 2: Deregulation

- 42.2 There would be cost savings to OFT and business linked with not running or requiring compliance with a licensing regime or its substitute, though some cost savings may be offset by increased enforcement activity in order to deal with problem consumer credit businesses that were not identified earlier.⁶⁰ However, there would

⁵⁸ This rests on the assumption that consumers benefit from an updated extortionate credit test, an ADR mechanism, and the existing provisions of the Act on agreements, advertising etc.

⁵⁹ This option encompasses a range of solutions from instituting several voluntary regimes enforced and established by trade associations with no OFT involvement, to a voluntary code of practice approved by OFT under its Consumer Codes Approval Scheme. For the purposes of calculating costs and benefits, we take the example of OFT's Consumer Codes Approval scheme, with a registered code sponsor (such as a trade association) monitoring compliance. This option assumes no change to the time order provisions.

⁶⁰ Abolishing the licensing regime would reduce the cost to the public purse of the system and eliminate the costs for business of paying licence fees and providing information to OFT. The costs of running the licensing regime are around £6m per annum, of which £2m is the cost of the Consumer Credit Licensing Bureau, £1.7m is spent on investigation and adjudication, and £2.3m on other supporting costs. Total fees received in 2003-2004 were £5,932,000 (OFT Annual Report). Around 16,000 licences are issued per year (OFT Annual Report). We understand it takes between 30 minutes and one hour for an applicant to complete a licence application

be no benefit for consumers, and the cost savings are likely to be offset by the effects of a general increase in consumer detriment in the market. There would be no additional costs imposed by changes to requirements on post-contract disclosure and time orders.

Option 3: Proportionate Regulation

42.3 The following benefits would arise from strengthening the licensing regime:

- (a) more rigorously enforced and targeted standards of fitness would be more effective in keeping credit businesses that trade unfairly out of the market, and would enhance consumer protection. A more stringent fitness test for licence applicants would enable OFT to prevent rogue traders from entering the market and exclude unfit lenders, so reducing consumer detriment, which is manifested in complaints to consumer credit businesses, advice organisations, and by court cases;⁶¹
- (b) strengthened OFT powers to ensure ongoing fitness would also bring benefits for consumers by improving trading practices generally. This is because poor behaviour in dealing with consumers (whether or not it is in the area of consumer credit) reflects on the business and would call into question its fitness to hold a licence;⁶²
- (c) OFT would be able to act proportionately to ensure standards of fitness were maintained, by imposing requirements on licences (after the business in question has been invited to make representations), and to impose a financial penalty on the consumer credit business if that requirement were breached. This would reduce consumer detriment, as OFT would have the appropriate tools to tackle varying degrees of unfit behaviour.⁶³ These requirements could also be publicised – a further deterrent on business from not complying with the fitness requirements;
- (d) indefinite licences would reduce the administrative costs for business and OFT compared with the current five-yearly

form. Assuming a cost to a business of £15 per hour, abolition of licensing would save business administration costs of £120,000 to £240,000 per year.

⁶¹ See Part 1: consumer detriment. In the Financial Year 2003-04, OFT received 17,802 licence applications and issued 16,683 licences; 56 letters saying OFT was “Minded to Refuse” a licence application were issued. In future, with a strengthened fitness test, we expect more applications to be refused. As the regime becomes embedded there will be fewer unfit businesses in the market, which should lead to fewer complaints and investigations by OFT. (Currently, OFT obtains 3,000-4,000 complaints per annum, of which c.850 merit opening an investigation).

⁶² OFT’s Consumer Detriment report of February 2000 found total consumer detriment across the economy valued at £8.3bn: raising standards through the licensing regime will help reduce this consumer detriment.

⁶³ Currently, OFT issues around 250 warning letters to consumer credit businesses for unfit behaviour during the currency of the licence. We expect that around 20-30% of these warnings would in future merit consideration for imposition of a requirement on the licence; requirements might also be imposed at the time of application.

licence renewal (currently around 12,000 licences are renewed per year). OFT estimates that savings might be around 20% of the current costs of running the Licensing Bureau (i.e. around £400,000 per year), though these savings will be devoted to enhanced fitness checking and investigations. With more targeted licensing, some businesses might choose a limited licence, and will therefore be required to provide less information to OFT than others would, meaning the burden on some businesses would not increase significantly; and

- (e) the licensing requirements will be phased in over a transitional period (to be specified), with commencement dates which allow preparation time for business, and enable OFT to spread its costs of dealing with the changes to the licensing regime.

42.4 Introducing requirements about post-contractual disclosure of information would:

- (a) provide consumers with more information about their credit agreements, which would in turn make them more aware of the implications of decisions that can affect their ability to meet their financial obligations;
- (b) serve to protect consumers from unscrupulous administration practices that exist in the market and which are designed to take advantage of consumers by exploiting the information asymmetry between consumer credit businesses and consumers;
- (c) enable consumers to challenge non-compliant conduct by consumer credit businesses on an informed basis and empower them to use their new rights under the unfair credit test and the ADR mechanism;
- (d) improve business performance through encouraging better financial management by consumers and alerting consumer credit businesses to problems at an earlier stage;
- (e) provide credit businesses with minimum standards of conduct in relation to the administration of credit agreements; and
- (f) provide better incentives for compliance through the introduction of specific requirements and also to allow for OFT enforcement under Part 8 of the Enterprise Act 2002 in respect of non-compliant conduct by consumer credit businesses that harms the collective interests of consumers.

42.5 In addition to reducing consumer detriment, which is not readily quantifiable, our proposed reforms can provide consumer benefits. The provision of clearer pre-contractual information (as required

by the new Consumer Credit Regulations) will allow consumers to shop around and potentially achieve a better deal prior to entering into the agreement.⁶⁴ The proposed requirements in relation to additional post-contractual information may encourage consumers to switch to cheaper products. The provision of clearer post-contract information is expected to be directly attributable to £153 million of consumer savings a year.⁶⁵

- 42.6 These benefits will combine to make the consumer credit market operate more effectively, through creating an environment where consumers are better informed about and more discerning in their credit decisions and in their dealings with consumer credit businesses. This will serve to discourage non-compliant conduct and improve the general standards of behaviour with positive effects for competition.
- 42.7 The proposal to bring forward the time at which a consumer may apply for a time order will:
- (a) improve consumers' ability either to obtain relief from onerous payment terms or to renegotiate payment terms with lenders, enabling better credit management and decreased costs in terms of seeking advice and legal costs;
 - (b) improve lenders' ability to enter into discussions with consumers at an earlier stage, which will serve to allow them to more efficiently recover loans from those consumers in non-critical financial distress. Cases would not reach the default stage when the consumer has exhausted their ability to repay which would lead to lower rates of non-recovery; and
 - (c) benefit the courts system as, while there is a risk of additional applications, we estimate that the increase will not be significant, given the increased incentive for consumer credit businesses to resolve disputes and negotiate rescheduled repayments at an earlier time, thus decreasing the need for applications and subsequent enforcement action.⁶⁶

⁶⁴ See the RIAs for each of the Consumer Credit Regulations made in June 2004. These may be found at http://www.dti.gov.uk/ccp/topics1/consumer_finance.htm#review.

⁶⁵ It has been estimated that consumers could save £1.9 billion a year in interest payments alone, by switching to cheaper credit cards. This is based on the £52 billion outstanding credit card debt moving from the average interest rate of 15.3% to the average of the lowest quarter of 11.7%. (A similar exercise by Which? in June 2002 also estimated this saving to be in the region of £2 billion). Assuming similar relative savings can be made across all unsecured borrowing, we predict that if just 5% of borrowers switch to cheaper loans and credit cards this will generate a consumer benefit of £306 million a year. This benefit is generated by a combination of policy reforms; new rules in relation to post-contractual information are assumed to generate half of this benefit.

⁶⁶ n.b. the DCA does not record statistics as to the total number of time order applications under the Act made in a year. We estimate that there were c.550 time orders made in England and Wales in 2002, based on an assumption that, at most, c.0.033% of County Court applications relates to time orders (based on a review of applications made at a busy County Court Registry, comparison to DCA published statistics and our discussions with Court officials, legal practitioners and District Judges). This means that a District Judge deals with c.1 or 2 time order applications annually. An increase in applications of between two and fourfold

Option 4: Voluntary Codes

42.8 The benefits of Option 4 would be lower than either Option 1 or Option 3,⁶⁷ though consumers would benefit from some protection compared with Option 2. Option 4 would only deliver benefits to clients of businesses who had chosen to adopt the new code or codes of practice.

42.9 Having said that, Option 4 would have the following benefits:

- (a) compared with the current licensing regime, costs would be lower for OFT;⁶⁸
- (b) businesses who adhered to a code (estimated to number c.1,500) would save licensing fees but we estimate the cost of information provision would be similar to the current cost of providing information to OFT. Those who did not adhere to a code (estimated to be around 104,500 businesses) would incur no licence fee and no costs of information provision;
- (c) it would provide consumer credit businesses with an OFT-approved⁶⁹ indication of a general standard of conduct for the administration of credit relationships; and
- (d) a code would provide incentives for consumer credit businesses to comply with the standard by allowing compliance to be a “hall-mark” of quality for consumers and to enable consumers to obtain redress under any code of practice.

43. Costs

Option 1: Do nothing.

43.1 Option 1 would result in no additional costs.

Option 2: Deregulation.

43.2 The costs of running the regime for OFT, and the costs of complying with it for business would be lower than for the other options. However, the costs for consumers would be higher than under any other option because the absence of regulation would increase scope for unscrupulous operators. Reputable consumer credit businesses would also face the cost of lower consumer confidence in the market.

43.3 In particular:

would mean there would be between 1,100 and 2,200 time order applications per year in England and Wales. Adding between 100 and 200 cases for Scotland and Northern Ireland to our current estimate of the potential number of applications gives an estimate of between 1,200 and 2,400 time order applications per year (i.e. an additional 600-1,200 applications per year).

⁶⁷ We have set out the reasoning for this conclusion in paras. 30.4 – 30.6 above.

⁶⁸ The cost to a trade association sponsor of establishing and publicising an Approved Code scheme is estimated to be c.£200,000, compared with administrative costs of around £6m per year to run the licensing regime.

⁶⁹ To obtain OFT approval consumer credit businesses will need to satisfy the requirements in respect of such codes set out in the Enterprise Act and in OFT’s own guidelines, and as such, cannot be taken for granted.

- (a) the current level of consumer protection would decline because any person could enter the consumer credit market without scrutiny. Regulation would be purely reactive, as problems would have to be manifest before any action could be taken. Thus, those who handle consumers' money, tie consumers into serious commitments (including loans secured on their homes), and collect debts would be free to operate without checks until the problems they cause came to light;
- (b) without the confidence that OFT has screened consumer credit businesses, consumers may incur additional costs in determining their fitness. The loss of consumer protection in this area, whilst other reforms to the Act to improve protection are underway, could confuse consumers, and undermine the effectiveness of the other reforms;
- (c) consumers would be much more likely to suffer detriment resulting from agreements provided by unfit consumer credit businesses. They would have to pursue redress using the ADR system or the courts.⁷⁰ If there were no licensing regime to exclude unfit consumer credit businesses, the number of complaints might increase by 10-25%;⁷¹
- (d) the retention of the licensing system also allows lenders to have some confidence in the fitness of those other consumer credit businesses, such as brokers and debt collectors, with whom they deal. Abolishing the licensing system would increase the burden on business to ensure that other consumer credit businesses with whom they deal were reputable because they would lack an objective record of licensed businesses and it would take considerably more time to determine another business's *bona fides*;
- (e) without a licensing system, the ADR would have no list of consumer credit businesses on which they could raise a levy and would therefore increase the case fee to cover its costs, imposing additional costs on business.⁷² Administration of the ADR might also be more difficult, because it could not rely on the list of consumer credit businesses, but rather would have to be made a compulsory mechanism for consumer credit cases;
- (f) fit consumer credit businesses would suffer from the loss of consumer confidence in the market and businesses would face increased uncertainty about what was required of them; and

⁷⁰ We estimate in the Rights/ Redress RIA that there would be up to c.10,300 cases per year going to ADR.

⁷¹ This gives a total of between c.11,300 and c.12,900 cases per year. Assuming each case costs £550, this means an additional cost of c.£0.6 million to c£1.4 million per year.

⁷² The case fee would rise to approximately £550 (the cost per case to FOS).

- (g) OFT would also lose information it holds currently about traders, which can help in targeting guidance.

Option 3: Proportionate Regulation.

43.4 The costs to OFT and for business in complying with this regime are higher than for the other options. However, Option 3 provides the greatest reduction in consumer detriment.

43.5 The costs of the reformed licensing regime would be:

- (a) increased licence fees for business. With c.106,000 active consumer credit licensees,⁷³ the change in the cost of the licensing regime will translate into a modest sum for most businesses, which we estimate at £18-26 for a sole trader and £44-66 for any other business;⁷⁴
- (b) possible higher costs of information provision to OFT under the strengthened licensing regime, where the risk assessment or concerns over competence mean that more information is needed to establish fitness;⁷⁵
- (c) the cost of compliance is not expected to rise for fit businesses, which currently comply with existing guidelines.⁷⁶ OFT's guidance on the new fitness test, will explain the requirements, and how the standard of fitness will be assessed. This guidance will be consulted upon and will be available in good time before the reforms come into force, to give business time to prepare;
- (d) costs for previously unlicensed businesses providing credit information services and debt administration businesses in becoming licensed (licence fee and costs of compliance); and
- (e) costs for OFT (and Trading Standards Departments) in running the new licensing regime. It is proposed that over a five-year transitional period, new indefinite licences will be issued, as each licence comes up for renewal. The costs to OFT of running the new licensing regime are therefore expected approximately to double to a peak of around £12m per year in the fifth year of operating the new regime, and thereafter to fall.⁷⁷ There will also be some implementation

⁷³ MORI estimates there are 105,932 consumer credit businesses, based on 125,000 licences in use and an average of 1.18 licences per business.

⁷⁴ We estimate that the additional direct licensing costs for typical businesses will be as follows: for a typical sole trader, which represent 40% of consumer credit licensees, an increase to the current 5-yearly licence fee of c.£110 of 80-120%, giving a yearly increase of c.£18-26 per licensee; and for any other business, an increase to the current 5-yearly licence fee of c.£275 of 80-120%, giving a yearly increase of c.£44-66 per licensee.

⁷⁵ The information requested will be of the sort that is readily available to businesses, so no collection costs will be imposed on business. Formal powers of investigation will be exercisable only subject to tests detailed on the face of the Act, and OFT and FSA will share information.

⁷⁶ It is estimated that around 1-2% of the licensing population will be subject to further investigation, and will therefore incur the additional costs (e.g. costs of providing further information) related to this.

⁷⁷ These costs (funded by the licence fees) will rise incrementally from the current £6m cost over the five years in which existing licences will be renewed according to the new test, and then will fall as all existing

costs for OFT in designing the new licensing structure, preparing and publishing guidance and staff training. These are estimated to be around £500,000.

- 43.6 The costs of the proposals on post-contractual disclosure would be:
- (a) transitional costs for business of establishing the systems to ensure compliance with the new requirements. The transitional costs to business of regulations on pre-contractual disclosure were estimated at around £160 million.⁷⁸ We expect these proposals on post-contractual disclosure⁷⁹ will be significantly less costly as many of these new informational requirements will require an incremental increase in the amount and form of the information that is provided by many consumer credit businesses;⁸⁰
 - (b) ongoing costs for business in providing disclosure to consumers. This will only be significant in respect of the requirement of annual statements (which will be limited only to fixed-term credit accounts which run for longer than 12 months) as most of the other information can be provided as part of existing forms of notification or the annual statement;
 - (c) costs for business in dealing with an increased potential for complaints by consumers in relation to post-contractual issues arising from the additional information available to them, which we expect will be offset by increased debt recovery as discussions will be held at an earlier stage; and
 - (d) costs to OFT of preparation of OFT Information Sheets in accordance with the requirements of secondary legislation.

43.7 We estimate that at present there are c.600 time order applications in the UK each year,⁸¹ and that the reforms will mean there will be between two and four times the number of time orders that are currently applied for. This will give rise to the following costs:

consumer credit businesses will have moved to the new regime, and the Licensing Bureau will be dealing largely with applications for indefinite licences, not routine renewals.

⁷⁸ This is based on a cost of £5,000 to each small consumer credit businesses c.£25,000 to each medium sized consumer credit businesses and £100,000 to each large consumer credit businesses. Cost information was taken from consultation with industry.

⁷⁹ These costs will consist of legal costs, management time, administration costs, printing costs and IT development and installation costs. If consumer credit businesses are provided with a sufficient adjustment period, trade associations could provide template notices and statements for their members - as happens already - which would substantially reduce costs for individual businesses.

⁸⁰ This is because the majority of consumer credit businesses either already provide such information to their customers or collect it for their own purposes (i.e. account management and recovery). Annual statements will be required only for fixed sum credit for more than 12 months, and so most short term and running account credit will not be affected and the notices will only be required in the event of arrears or default. The new requirements will be known well in advance of the required implementation date, giving business time to prepare for the change. These costs could be built into existing revision schedules for industry, to further reduce the cost, and consumer credit businesses that are members of trade associations will be able to use standardised forms and notices.

⁸¹ See footnote 64 above.

- (a) for consumers, the litigation cost of bringing applications would be between £1.4 and £3.1 million.⁸² For those cases that are successful, the consumer may be able to recover a significant proportion of the costs from the lender;
- (b) for lenders, the increased likelihood of applications may impose costs of dealing with the negotiations that will be required before an application can be made and the litigation costs of such applications for lenders would be between £1.4 and £3.1 million.⁸³ On the basis that lenders will achieve a higher level of recovery we do not think that this proposal will impose additional costs on lenders;
- (c) for OFT, the cost of preparing a leaflet about time orders and their availability for distribution in court registries, advice centres and local government; and
- (d) for the courts systems in England & Wales, Scotland and Northern Ireland, we think that there will be the following costs:
 - (i) the amendment of forms in England & Wales – £30,000;⁸⁴
 - (ii) in respect of the number of additional applications being made, we estimate that the increase will be between two and four times the current number of claims, the cost of which would be met out of the case fee payable for each case.⁸⁵

Option 4: Voluntary Codes

43.8 The costs of introducing a voluntary regime are:

- (a) costs to consumers are likely to be significant because unscrupulous businesses would not sign up to the code and would trade unfairly. The total consumer detriment is likely to be around half of that for Option 2,⁸⁶ but the extent to which it is lower depends on the benefits of joining the code (whether or not consumers trust it, whether compliance with the code is needed for membership of a trade association and its associated benefits) and how effectively it is enforced.

⁸² Based on an additional 600-1,200 applications per year (see footnote 66 above), and on the basis that an application for a time order would cost between £2,400 and £2,550 per party (calculated on the basis of typical fee levels for lawyers and court fees), we estimate that the cost of additional litigation would be between £2.9 and £6.1 million per annum.

⁸³ See previous footnote.

⁸⁴ Estimate provided by the DCA for the amendment of forms in England & Wales. We have confirmed with the Scottish Executive's Civil Justice Department and the Northern Ireland Court Service that there will be no costs arising from the amendment of the relevant forms in Scotland or Northern Ireland.

⁸⁵ The court fee for a time order application is currently £139. The amount is in keeping with the DCA's requirement for full cost recovery in respect of applications made. Litigants with specific financial difficulties may seek to have the fee reduced or waived in accordance with the Courts Services' guidelines.

⁸⁶ The reasoning for this conclusion is set out in paras.30.4-30.6 above.

- (b) compliance costs for businesses signing up to the code. If the codes required the same level of fitness and post-contractual disclosure of information as that set out in option 3, the costs of compliance for business would be the same as for option 3. The total cost would depend entirely on the level of membership of the code, but since such codes would be signed up to by fewer businesses than currently require a licence, it would be lower than the total cost for option 3.
- (c) costs to OFT and Code Sponsor in drawing up the code, advertising it, and monitoring compliance with it. In order for a code of conduct to work effectively, sufficient emphasis must be placed on raising consumer awareness of the code. The estimated average cost for a Code Sponsor is c.£200,000,⁸⁷ though the precise cost would depend on the total membership of the code.

44. Costs for a typical business:

44.1 **The cost of compliance** - The proposed reforms mean that a typical consumer credit business will incur direct costs in respect of compliance with the requirements of licensing system and the provision of required post-contractual information (such as annual statements and arrears notices).

44.2 **Licensing costs:** We estimate that the additional direct licensing costs for typical businesses will be as follows:

- (a) for a typical sole trader, which represent 40% of consumer credit licensees, an increase to the current 5-yearly licence fee of c.£110 of 80-120%,⁸⁸ giving a yearly increase of c.£18-26 per licensee.
- (b) for any other business, an increase to the current 5-yearly licence fee of c.£275 of 80-120%,⁸⁹ giving a yearly increase of c.£44-66 per licensee.

44.3 **Post-contractual information costs - provision of required post-contractual information:** These requirements will affect only those consumer credit businesses that are lenders, which form less than 5% of consumer credit licensees. It is difficult to estimate the actual cost to lenders of these requirements, as it is highly dependent on the state of the lender's existing systems:

- (a) **costs for small businesses** – small business costs will be limited by their predominance in those parts of the market involving low-value, short-term lending of less than 12 months' duration. Therefore, many will not be required to

⁸⁷ Source: OFT.

⁸⁸ Source: OFT. The final amount of the licence fee for sole traders has not been determined.

⁸⁹ Source: OFT. The final amount of the licence fee for incorporated bodies has not been determined, and may vary according to the categories of licensable activities undertaken.

provide annual statements and will have specific requirements, taking account of their circumstances, in relation to the provision of arrears statements. They will also often have no obligation to provide notices of fees and charges because of the simple charging structure of their agreements. The cost of providing arrears notices and notices of fees and charges will be an incremental cost, being part of business recovery costs.

- (b) ***costs for other businesses*** – Industry good practice generally requires lenders to provide consumers with information about the state of their account, any arrears and any additional fees and charges. The primary cost to business will be the requirement for the provision of an annual statement. Many businesses already provide this information, and so the cost of providing information in the required format will be incremental, reflecting the need to provide the information in a specified format. Again, the impact of the changes in respect of information arising out of arrears and default will be limited and represent an incremental increase, and generally only apply in those circumstances where the lender already is incurring costs in relation to recovery.
- (c) ***estimate of the cost to a typical business*** - We estimate that the cost to a business on complying with the proposed requirements in relation to post contract transparency will be considerably less than the cost of complying with the new requirements on pre-contract disclosure and form and content (as required in the new Consumer Credit Regulations). This is because these changes apply only to lenders and, apart from annual statements, the requirements apply only in cases of default.⁹⁰
- (d) ***ongoing costs to business*** – The primary ongoing cost to business will be in respect of the provision of the annual statement. As we have said, this will be an incremental cost to most of those businesses required to provide these statements, as many already provide this information to consumers in some form. In respect of other notices, these will apply in relation to situations of arrears and default, both of which are highly dependent on the nature of the lender's business.

⁹⁰ On this basis, we have estimated that the cost to business will be 10-50% of the cost to business of complying with the new requirements in relation to pre-contract disclosure. This estimate is based on the figures used in the RIAs relating to the form and content of agreements. In those RIAs we estimated that of the estimated cost to a small business of rewriting its agreements of £5,000. We estimate that the cost of developing new post-contract information will be 10-50% of that cost, or £500-£2,500, bearing in mind that this requires the introduction of 4 standard notices –relating to annual statements, arrears notices, the notice relating to fees and charges and notices in relation to post-judgment interest.

- 44.4 Businesses will also incur indirect costs in relation to training staff and maintaining and auditing systems to ensure ongoing compliance with the Act. Direct costs will represent an incremental increase to existing costs to business. Indirect costs may represent an incremental increase for those businesses with compliance systems already in place, and an additional cost for those that do not.
- 44.5 ***The cost of alleged non-compliance*** - If a consumer credit business is the subject of OFT action in relation to licensing issues, then the business may incur one or more of the following costs:
- (a) the cost of dealing with OFT requests for additional information;
 - (b) legal fees and other associated costs in respect of OFT licensing proceedings;
 - (c) a financial penalty, if the business breaches a licence requirement;
- 44.6 These are the costs of alleged or actual non-compliance with the Act. The vast majority of businesses are compliant and will remain so, and will not have to incur these costs.
- 44.7 ***Other costs*** – the cost of time orders will depend on the number of applications made. At present very few applications are made in the UK. The proposed reform is designed to encourage consumers and lenders to discuss repayment issues at an earlier time, and not to encourage more applications. For this reason the notification requirement has been placed on consumers. We do not anticipate that time order applications will increase significantly, and so any increase in costs to business of dealing with these applications should be incremental.
- 45. Business sectors affected:**
- 45.1 **The effect on business of the cost of compliance** - All business sectors in the consumer credit market will incur the costs of complying with the Act. These costs have been identified above. The direct costs of compliance with the licensing regime apply to all consumer credit businesses (albeit at varying levels) and in most cases will represent an incremental increase to current costs of compliance (although credit information service providers and debt administrators, who do not currently require a licence, will face this new cost).⁹¹ Costs in relation to post-contractual disclosure will be incurred by lenders and not by intermediaries.

⁹¹ Following consultation with the industry working group on credit repair, we estimate that there are up to 100 such businesses who will need a licence, of which some may already have a licence, if they also undertake other licensable business, such as debt-counselling. We also expect that many debt administrators will already have a debt collection licence or consumer credit business licence.

- 45.2 In terms of OFT's oversight of licensing, there are sectors that may, because of a potential for increased consumer detriment in those sectors, be the subject of additional OFT scrutiny in relation to fitness to hold a licence and also may be required to operate subject to certain conditions which may result in increased costs.
- 45.3 Based on the current number of active consumer credit licences, we estimate that the total additional cost of direct of compliance to consumer credit businesses will be:
- (a) c.£0.8 –1.1 million per year for all sole traders,⁹² and
 - (b) c.£2.8 – 4.2 million per year for other businesses.⁹³
- giving a total additional cost of direct compliance with the new licensing regime to business of c.£3.6 – £5.3 million per year. This amount will be in addition to the c.£6 million currently paid annually for consumer credit licences.
- 45.4 We estimate that the cost to small business of introducing the new post-contract information requirements would be a one-off cost to all small businesses c.£1.1 million.⁹⁴ We estimate that the cost to small business of introducing the new post-contract information requirements would be a one-off cost to all small businesses of c.£31.5 million.⁹⁵
- 45.5 **The effect on business of the costs of alleged non-compliance** - As we have stated above, the vast majority of businesses comply and will do so in future. However, some business sectors may be more exposed to costs of alleged non-compliance than others. The potential for redress action will largely be confined to lenders and finance brokers, as non-compliance by these businesses is the most likely source of significant harm to consumers in respect of credit.

⁹² Based on 40% of 106,000 active consumer credit licences (c.42,000) multiplied by £18-26.

⁹³ Based on 60% of 106,000 active consumer credit licences (c.64,000) multiplied by £44-66. This is based on the current incorporated body licence fee of £275. Under the reforms, OFT will have the power to vary licence fees according to the size of the applicant or licensee's business or the nature of that business.

⁹⁴ This estimate is based on the figures used in the RIAs relating to the new Consumer Credit Regulations on the form and content of agreements. In those RIAs we estimated that of the estimated cost to a small business of rewriting its agreements of £5,000. We estimate that the cost of developing new post-contract information will be 20% of that cost, or £1,000, bearing in mind that this requires the introduction of 4 standard notices –relating to annual statements, arrears notices, the notice relating to fees and charges and notices in relation to post-judgment interest. We estimate, based on the MORI survey of consumer credit licences conducted for DTI, that 5% of licensees are lenders (i.e. 5,000) and 22% of lenders are small businesses (i.e. 1,100).

⁹⁵ This estimate is based on the figures used in the RIAs relating to the new Consumer Credit Regulations on the form and content of agreements. In those RIAs we estimated that of the estimated cost to a intermediate business of rewriting its agreements of £25,000 and to a large business £100,000. We estimate that the cost of developing new post-contract information will be 20% of those costs, or £5,000 and £20,000, bearing in mind that this requires the introduction of 4 standard notices –relating to annual statements, arrears notices, the notice relating to fees and charges and notices in relation to post-judgment interest. We estimate, based on the MORI survey of consumer credit licences conducted for DTI, that c.5% of licensees are lenders (i.e. 5,000) and 78% of lenders are not small businesses (i.e. 3,900). Of these, we estimate that 80% are intermediate businesses (i.e. 3,100). Therefore, the cost to intermediate businesses would total c.£15.5 million and the cost to large businesses will be c.£16 million.

46. Issues of equity and fairness

- 46.1 The proposed reforms are not intended to affect any particular sector of the consumer credit market more than any other. All consumer credit businesses will incur incrementally higher direct and indirect compliance costs.⁹⁶ The reforms are intended to ensure that all consumer credit businesses act according to consistent rules and standards of conduct in the operation of their businesses and in relation to the provision of credit to consumers.
- 46.2 Having said that, the reforms are designed to improve the position of those consumers who are vulnerable to exploitation when they obtain credit due to personal and situational factors. In some sectors of the market the degree of consumer vulnerability to unfairness and exploitation is higher, because of the types of consumers served by that sector and the manner in which lenders have lent historically. Those consumer credit businesses that participate in such sectors could have a higher risk of incurring the costs associated with alleged non-compliance.

47. Consultation with small businesses: the Small Firms Impact Test

- 47.1 The consumer credit industry involves many small firms: 40% of all licensees are sole traders, and 55% of all licensees employ less than 10 people.⁹⁷ We have consulted, and continue to work with trade associations representing small firms and their members. We aim to avoid undue burdens on small business, and are balancing the costs of the reforms with the benefits of consumer protection.
- 47.2 Small firms have expressed some concern over the costs of compliance with the reformed Act. However, the new licensing fees are not anticipated to be very high (they are estimated to be around £220 at each periodic charging point for a sole trader), and the information requested by OFT as part of fitness testing will be readily available to the business, and will not require significant additional work to find and collate. OFT guidance to explain how to comply with the fitness requirements will be available in good time before the reforms come into force.
- 47.3 Lenders who are sole traders predominate in those sectors of the market that offer low-value short-term loans. Some aspects of the requirements will not affect many of these agreements as they will not apply (e.g. annual statements and notices about fees and charges) or specific provision has been made to account for different repayment and default patterns in these sectors (e.g. arrears statements). Therefore, the impact of these changes will

⁹⁶ Though, as noted above, previously unlicensed credit information service providers would incur the costs of complying with the licensing regime for the first time.

⁹⁷ Source: MORI research on consumer credit licensees

be limited and represent an incremental increase, and will generally only apply in those circumstances where there is a situation of arrears or default, where the lender already is incurring costs in relation to recovery. Small businesses will also benefit from being able to use templates provided by trade associations, and therefore will not incur significant costs in developing forms. Those without access to such templates may incur higher costs, although these will be limited by the limited requirements made of them in this respect.

47.4 Consumer credit businesses will also be assisted by OFT guidance on licensing and enforcement.

48. Enforcement and Sanctions

48.1 At present the Act provides few realistic enforcement and sanctions options for regulators. OFT cannot do anything other than seek to revoke, vary or suspend a non-compliant consumer credit business's licence, and has few powers to compel consumer credit businesses to assist with its investigations. This means that enforcement of a type that does not relate to the most serious conduct is generally unable to be dealt with proportionately.

48.2 With these reforms, the Government seeks to provide for better targeted and more proportionate public enforcement, which enables specific lenders and sectors to be targeted by OFT (and by Trading Standards Departments at local level), and for proportionate sanctions, including licence requirements.

48.3 By making these changes, we intend to ensure that enforcement and sanctions can be addressed to all significant problems that arise under the Act, and not to only the most extreme.

***Specific Regulatory Impact Assessment:
Making regulation appropriate for different types of consumer credit
transaction***

49. Title of proposal

49.1 The amendment of the Act to remove the financial limit for the regulation of consumer borrowing, to allow for specific opt outs and exemptions from regulation for specific categories of transaction, and to remove the automatic unenforceability of contracts for non-compliance with prescribed requirements.

50. Purpose and intended effect of measure

The objective

- 50.1 We propose to remove the financial limit for the regulation of consumer credit.
- 50.2 We propose to take steps to ensure that regulation is appropriately targeted and does not unduly constrain lending to consumers where the primary function of the borrowing is commercial or the consumer is a person of means who can confidently opt out of regulation (and who otherwise may do so by opting for offshore sources of funds).
- 50.3 We also propose to make the Act proportionate in terms of the enforceability of agreements, which can now act in a manner that is unduly harsh to consumer credit businesses.

Background

The financial limit

- 50.4 We propose to remove the current financial limit for the regulation of consumer borrowing, in order to extend statutory protection to cover significant areas of consumer borrowing that are presently not regulated by the Act.
- 50.5 The current financial limit is £25,000, which was introduced by order in 1998. This does not represent a significant level of borrowing for many consumers with the increase in general levels of borrowing and the development of the second-charge mortgage market.⁹⁸ Furthermore, an increasing number of consumers are being encouraged to consolidate their unsecured consumer credit debts into a secured loan, often for an amount higher than £25,000 and sometimes with higher credit costs and risk to security. This lack of regulation is highlighted by the fact that as from 31 October 2004, FSA has regulated first-charge mortgages, for which there will be no financial limit.

⁹⁸ Indeed, when adjusted for inflation, the original £5,000 limit introduced in 1974 would now amount to a loan of c.£56,000.

Enforceability of agreements

- 50.6 We propose also to reform the provisions in relation to automatic unenforceability of agreements that do not comply with prescribed requirements in the Act as to form or the provision of a cancellation notice to introduce a more proportionate approach. The current rules allow that agreements may be unenforceable even where there is a very minor error or oversight. These rules are not proportionate and can act so that consumer credit businesses are unable to enforce credit agreements where the consumer cannot demonstrate a valid problem with the agreement. With the removal of the financial limit, which currently limits such exposure, there will be a much higher level of risk for consumer credit businesses and the potential for a far higher degree of opportunistic conduct by some consumers.
- 50.7 We do not propose to curtail the right of consumers to challenge faulty agreements, but to leave the question of enforceability of all or any term of the agreement to the discretion of the court.

High net worth lending

- 50.8 In respect of “high net worth” consumers,⁹⁹ we have considered the concerns of industry that such consumers seeking large sums by way of personal borrowing would, if constrained by regulation under the Act, simply move their business to offshore financial centres with the consequence of a significant reduction in business for British consumer credit businesses.

Business lending

- 50.9 One important aspect of the reforms is not to apply consumer protections to general business lending. Therefore, we propose exemptions to do this, except in the cases of very small businesses where the circumstances of those involved are more akin to consumer transactions.

51. Risk assessment

- 51.1 The Government wants to ensure appropriately targeted and proportionate regulation of credit agreements. The consumer credit market has undergone immense changes since the Act was passed in 1974, and in many cases the type of regulation it envisages is either no longer appropriate or simply inadequate to deal with the changes in Britain’s credit market over the past 30 years.

⁹⁹ A “high net worth” consumer will be defined as a person who satisfies one of two criteria: an annual income above a specified level or net assets of a value above a specific level (but without reference to the value of the consumer’s principal place of residence).

Financial limit

- 51.2 The risk is that, with no increase in the financial limit, a growing number of loans to ordinary consumers – in particular secured debt consolidation loans and second mortgages – would not be regulated by the Act. There is a risk that consumers would wrongly believe that they are protected and, as a consequence, experience detriment.
- 51.3 In 2002 half of all second-charge mortgages (value £8.8 billion) taken out had debt consolidation as their main purpose.¹⁰⁰ Such lending often exceeds the £25,000 financial limit and has more than trebled in the last three years. With this growing trend there is a risk that a growing number of consumers will lack protection where it is needed the most: on credit agreements that are secured against their homes. This position has been thrown into sharper focus – as from 31 October 2004 FSA has responsibility for regulating all first-charge mortgages, irrespective of their value.

Appropriate regulation

- 51.4 In addition to ensuring that regulation under the Act exists for all of those ordinary consumers that should enjoy its protections, the Government is also aware of the risk of imposing unduly burdensome regulation on lending that, because of the parties involved or the size of the amounts involved, may be caught, despite being essentially for business purposes.
- 51.5 The Government also does not want detrimentally to affect the lucrative ‘high net worth’ lending sector by imposing regulation on it where those involved are generally sophisticated consumers capable of ensuring that their own interests are protected. Having said this, these consumers would still be able to challenge consumer credit business unfairness and so they would maintain their basic rights. Undue regulation may constrain the willingness of these consumers to obtain credit in the UK, and encourage them to seek credit offshore where they would have little or no protection.

52. Options

Option 1: Do nothing

- 52.1 Retain the current legislative position and financial limit of £25,000.

Option 2: Remove the financial limit and provide for appropriate regulation.

- 52.2 This option would target the protection of the Act where it is required – on consumer borrowing, while simultaneously ensuring that such protections were not extended where they were not required, in respect of business borrowers or desired, on the part

¹⁰⁰ See OFT March 2004 “Debt consolidation – A report on an OFT study”.

of high net worth individuals. This option would also introduce a more proportionate approach to the enforceability of agreements.

Option 3: Raise the current financial limit to a higher figure.

- 52.3 This option would not require primary legislation but could be effected under an existing power in the Act, raising the financial limit in the Act – in line with inflation – to a figure of around £50,000. The original financial limit in the Act was £5,000. This has been raised twice in line with inflation – in 1985 to £15,000; and again in 1998 to the current limit of £25,000. Based on the purchasing power of £5,000 in 1974, a comparable limit today would be c.£50,000 - £60,000.

53. Benefits

Option 1: Do nothing

- 53.1 Option 1 would maintain the current level of protection, and treats both consumer credit businesses and consumers equally. This option would provide no additional benefits to consumers, nor do we consider that it would provide any additional benefit to business, as it would not serve to create a more efficient consumer credit market.

Option 2: Remove the financial limit and provide for appropriate regulation.

- 53.2 This option recognises current trends in the consumer credit market by targeting protection where it is most needed. It would provide benefits in relation to the increased protection of consumers who otherwise would have no statutory protection for what are, in essence, consumer credit transactions (albeit of a high value).
- 53.3 Statutory protection would be based on the nature of the credit and the status of the consumer, rather than the less sophisticated approach of providing protection up to an arbitrary value. The indirect benefits of this option has become particularly apparent since FSA mortgage regulation has taken effect, as second-charge mortgages for over £25,000 are regulated by neither the FSA regime nor the Act.
- 53.4 The removal of automatic unenforceability of defective consumer credit agreements under s.127(3) of the Act would provide business with significant benefits in terms of greater certainty and also removing the risk of consumers using the current power opportunistically. This should be balanced with the potential for increased uncertainty in relation to unfair credit.¹⁰¹

¹⁰¹ See para.30.4 above.

Option 3: Raise the current financial limit to a higher figure.

53.5 A financial limit of £50,000 would have the benefit of covering around 99% of the volume of credit agreements and 87% of the value. This would, on a short-term basis, to close the majority of the regulatory gap mentioned in (b) above. This option would also be simple for both business and consumers to understand. It could be achieved quickly by way of secondary legislation under the Act.

54. Costs:

Option 1: Do nothing

54.1 Over time the percentage of consumers protected by the Act is likely to continue to fall and consumers may experience considerable detriment as a result, particularly as many consumers may not be aware that they are not protected.

Option 2: Remove the financial limit and provide for appropriate regulation.

Transitional costs

54.2 The proposed changes would not change the nature of the regulatory obligations placed on consumer credit businesses, but would merely increase the number of agreements to which they apply. As the majority of consumer credit businesses who offer loans of over £25,000 also lend amounts below that which are covered by the Act we do not envisage the need for substantial system changes by consumer credit businesses.

Compliance and continuing costs

54.3 We anticipate some additional costs associated with devising and operating tests to identify business lending and to deal with "High Net Worth" customers who wish to waive their Act protections. There may also be small additional compliance costs in terms of providing consumers with information requirements as governed by the Act.

54.4 The removal of the financial limit would also create an incremental cost for business in respect of:

- (a) the application of the reformed rules in relation to early settlement to loans of a value of more than £25,000 and which are otherwise not exempt; and
- (b) the application of the rules in relation to voluntary termination to hire purchase transactions of a value of more than £25,000 and which are otherwise not exempt.

Option 3: Raise the current financial limit to a higher figure.

- 54.5 This option leaves a regulatory gap. Although over 99% of agreements would be protected, leaving less than 1% unprotected, by value this is 13% and there would still be scope for considerable consumer detriment with larger credit agreements. The limit chosen would be an arbitrary one and there would be a need to monitor the situation to ensure that the new limit remained set at an appropriate level. It is likely that the limit would have to be regularly increased at points in the future in line with inflation and changes in the credit market.
- 54.6 This option would also do nothing to address the confusion that the two-tier system presents for consumers. Similarly consumer credit businesses would still be governed by two sets of rules, depending on the amounts involved.
- 54.7 It would not be desirable to increase the financial limit for business lending in line with the limit for consumer lending as it would be likely to result in the cost and access to higher value finance for small businesses being adversely affected. To overcome this it would be necessary to retain the current financial limit for business lending which would further complicate the situation.

Transitional costs to consumer credit businesses

- 54.8 The proposed changes would not change the nature of the regulatory obligations placed on consumer credit businesses, merely increase the number of agreements to which they would apply. Therefore we do not anticipate the need for significant system changes, and transitional costs would be minimal and lower than under Option 2.

Compliance and continuing costs

- 54.9 We anticipate small additional costs arising from the increase if regulation of business lending were extended up to the new limit, in respect of those agreements not now regulated by the Act. This would result from greater information provision for consumers and extending other protection under the Act such as early settlement rights to the credit agreements that fall under the new financial limit.

55. Preferred option

- 55.1 Our preferred option is Option 2: remove the financial limit and provide for appropriate regulation.

56. Costs for a typical business:

- 56.1 ***The cost of compliance*** - The proposed reforms mean that a typical consumer credit business will incur direct costs in respect of handling additional customers and making required disclosure for

additional credit agreements. Business may also incur indirect costs in terms of training staff and maintaining and auditing systems to ensure ongoing compliance with the Act in respect of additional requirements in relation to exempt lending.

56.2 *The cost of alleged non-compliance* – These reforms simply extend the range of credit agreements that are the subject of regulation by the Act. A failure to comply with the Act will mean that the business is exposed to possible additional costs in terms of both OFT action and also private redress.

57. Business sectors affected:

The effect on business of the cost of compliance

57.1 These reforms will primarily affect the following sectors:

- (a) those consumer credit businesses that lend to high net worth individuals; and
- (b) those consumer credit businesses that specialise in business lending.

57.2 In terms of OFT's oversight of licensing, there are sectors that may, because of a potential for increased consumer detriment in those sectors, be the subject of additional OFT scrutiny in relation to fitness to hold a licence and also may be required to operate subject to certain conditions which may result in increased costs.

The effect on business of the costs of alleged non-compliance

57.3 As we have stated above, the vast majority of businesses comply with the requirements of the Act and will comply with the reformed Act. However, some business sectors may be more exposed to costs of alleged non-compliance than others.

58. Issues of equity and fairness

The proposed reforms are intended to ensure that all lending to consumers can be protected by the Act and is not intended to impose artificial distinctions between certain types of lending. While this is so, the reforms make provision to ensure that lending which is primarily of a business nature is not regulated (including almost all business lending)¹⁰² and lending directed to high net worth consumers is able to be exempted provided that the consumer meets specific criteria. All consumer credit businesses that lend to businesses or high net worth consumers will incur incrementally higher direct and indirect compliance costs.¹⁰³

58.1 The reforms are also designed to improve the position of those consumers who are vulnerable to exploitation when they obtain

¹⁰² n.b. lending to small businesses (i.e. sole traders, unincorporated associations and partnerships with 3 or fewer partners) will be protected by regulation.

¹⁰³ Though, as noted above, previously unlicensed credit information service providers would incur the costs of complying with the licensing regime for the first time.

credit due to personal and situational factors (e.g. as is often the case with large debt consolidation loans) and to mean that those consumers who obtain credit above the current limit are protected in future. In some sectors of the market the degree of consumer vulnerability to unfairness and exploitation is higher, because of the types of consumers served by that sector and the manner in which lenders have lent historically. Those consumer credit businesses that participate in such sectors could have a higher risk of incurring the costs associated with alleged non-compliance.

58.2 The reforms also address the disproportionate impact of some provisions that provide for automatic unenforceability of loans because of technical non-compliance with specific requirements of the Act. This can mean that consumers can get out of their obligations because of a lender's technical mistake in loan documentation. The question of enforceability will now be left to the court's discretion.

59. Consultation with small businesses: the Small Firms Impact Test

59.1 We do not anticipate that these reforms will, except for the changes in relation to enforceability, have a significant impact on small lenders. Small lenders constitute only 22% of lenders, who are, themselves c.5% of the total number of licensees. The changes in enforceability will improve the position for all lenders, by meaning that the question of enforceability is left to the court, and is not automatic.

59.2 The majority of lenders in the business and high net worth sectors are large businesses, with the resources to extend large sums in credit. Furthermore, the introduction of a single regulatory regime for all consumer credit should reduce the administrative burden for small lenders, by requiring compliance with one set of rules.

60. Enforcement and Sanctions

60.1 These changes bring all consumer lending under the regulation of the Act, exposing all consumer credit transactions to the enforcement options and sanctions available under the Act.

ANNEX

Consumer Credit: Indicating the scale of consumer detriment in the United Kingdom

1. The basis of this analysis

- 1.1 OFT estimated that in 2000 the consumer detriment to all consumers in all consumer transactions was about £8.3 billion per year.¹⁰⁴ Consumer detriment in the consumer credit market is likely to be considerable, given the problems that many consumers face in terms of poor transparency and unfair practices by a small, but significant, proportion of consumer credit businesses.
- 1.2 This analysis does not seek to quantify consumer detriment in the consumer credit market. Any accurate assessment of this would be extremely difficult to calculate, even on the best information available. Rather, it seeks to indicate the scale of total consumer detriment in relation to those consumers who make enquiries to free advice providers and government bodies such as OFT and, where relevant, FOS and FSA.
- 1.3 This analysis does not factor in the consumer detriment for those:
 - (a) who cannot or do not make an enquiry;
 - (b) who pay excessive credit costs because they can afford to and who choose either not to make an enquiry or do not know that that can do something about the problem; and
 - (c) who obtain paid debt advice from a solicitor, accountant or debt management company.

2. The nature of consumer credit problems

- 2.1 We estimate that c.80% of consumers who bring enquiries to free advice providers have a general enquiry or are seeking advice on how to deal with problems arising from multiple borrowing, and do not dispute their liability for the debts they have.¹⁰⁵ Therefore, we estimate that c.20% of consumers are enquiring about a potential issue of unfairness or exploitation (which could relate to either general or specific issues concerning the consumer credit business's conduct in selling, making or administering the credit agreement). However, within the c.80% who do not dispute liability, we estimate that a further c.10-15% of consumers could have a substantive issue relating to irresponsible lending that has led to the situation escalating to the point of crisis.¹⁰⁶ This means

¹⁰⁴ OFT *Consumer Detriment* April 2000. OFT imposed significant qualifications on this figure.

¹⁰⁵ This figure is an estimate based on our review of consumer enquiries to free advice providers (see footnote 11 above). The proportion of issues that related to general debt advice and managing multiple debt was uniformly high for all free advice providers that we visited.

¹⁰⁶ Again, this figure is an estimate based on our review of consumer enquiries to free advice providers (see footnote 11 above). The proportion of issues that related to general debt advice and managing multiple debt

that c.35% of the 600,000 consumers who make an enquiry to a free advice provider, or c.210,000, could be affected by potentially unfair conduct. This percentage should not be applied to all consumers who obtain consumer credit.

3. The cost of dealing with enquiries

3.1 In the White Paper we estimated that the cost to all consumers of simply making enquiries is c.£40 million a year.¹⁰⁷ On the basis that c.35% of people who make enquiries have a substantive issue to be dealt with, the cost to consumers of making enquiries would be c.£14 million a year.¹⁰⁸

3.2 Additionally, we estimate that the cost to free advice providers of dealing with these enquiries was well in excess of c.£60 million in 2003-2004.¹⁰⁹ We do not think that this figure will change in the short term, and we note that the demand for money advice currently outstrips supply.

4. Indicating the extent of consumer detriment

4.1 The direct detriment to consumers from unfair lending practices is made up of such things as:

- (a) the cost of purchasing products that are not necessary or suitable for the consumer, but purchased because of misleading or high-pressure sales tactics;
- (b) excessively high interest payments;
- (c) excessively high fees and charges payable on default and default interest;
- (d) costs associated with the provision of inappropriate ancillary products;¹¹⁰
- (e) costs incurred by lenders in relation to recovery (i.e. debt collection and legal costs) and interest applied to those costs;
- (f) costs to the consumer associated with resolving issues and remedying the situation, including advice and legal costs; and

and which involved an issue of potential irresponsible lending was, small but significant in all sets of files we examined.

¹⁰⁷ See para.1.39 of "*Fair, Clear and Competitive – The Consumer Credit Market in the 21st Century*" White Paper (2003). This is based on the methodology used by OFT in its paper entitled *Consumer Detriment* (2000). The detriment figure is based on the number of complaints received regarding credit agreements and includes all the potential costs incurred by the consumer in complaining. These include legal and advice costs, telephone and stationery costs, the use of personal time and lost earnings etc. See table 6.5 of OFT paper for a fuller exposition of the costs included.

¹⁰⁸ However, we estimate that the actual cost of making such substantive enquiries would be much higher, reflecting the additional effort and expense to the consumer of pursuing a substantive complaint.

¹⁰⁹ This is composed of c.£970,000 for Citizens Advice Scotland, c.£18 million for Citizens Advice (England & Wales), c.£38 million for advice providers covered by Advice UK. The bodies concerned have provided these estimates. This does not include the cost to OFT of dealing with consumer enquiries and complaints. This information is based on data provided by the relevant bodies. The bulk of funding for these bodies comes from grants from local authorities, the Legal Services Commission and various charities and charitable trusts.

¹¹⁰ n.b. ancillary insurance products has been regulated by FSA since 31 October 2004.

- (g) costs flowing from the time and stress that the dispute causes.
- 4.2 In some cases these costs may result from specific unfair conduct by a consumer credit business. In other cases, the weaknesses of the existing law may have encouraged unfair lending practices by a lender or a number of lenders to be regarded as acceptable, and mean that a potentially large number of consumers pay more than they would otherwise. The fact that consumers have been reluctant to challenge agreements in the courts, and currently have very few other means of effectively doing so, has served to exacerbate consumer detriment.
- 4.3 To quantify this consumer detriment is extremely difficult, but we can say that with the increasing volume of consumer enquiries about consumer credit problems and the increasing size of the total amount of outstanding loans, it is considerable. Having said that, we can indicate the scale of consumer detriment based on a relatively modest average level of individual detriment to those consumers who make an enquiry to a free advice provider.
- 4.4 This indication does not factor in the consumer detriment for those:
- (a) who cannot or do not make an enquiry;
 - (b) who pay excessive credit costs because they can afford to and who choose either not to make an enquiry or do not know that that can do something about the problem; and
 - (c) who obtain paid debt advice from a solicitor, accountant or debt management company.
- 4.5 Assuming that:
- (a) in 2003 the average level of outstanding consumer credit debt per household was £6,464;¹¹¹
 - (b) that at least 210,000 consumers raise a potential issue of unfairness or exploitation with free advice providers;¹¹² and
 - (c) the detriment to an individual consumer is only 20% of the value of the amount of average outstanding debt, or c.£1,300,
- then the consumer detriment to consumers who make enquiries to free advice providers would be between c.£250-300 million a year.

¹¹¹ Average debt of consumers, 2003 data from FSA. See also DTI/DWP June 2004 *Tackling Over-indebtedness- Action Plan 2004*, p.13.

¹¹² See paragraph 4.1 above.

4.6 This amount may not seem large in the context of the total amount lent to consumers, but the scale of individual consumer detriment can often be devastating in the context of the personal circumstances of those who have serious limitations on their finances and on their ability to manage them.