



Consumer Affairs Directorate

STRENGTHENING CONSUMERS AND BUSINESS

# **REPORT BY THE TASK FORCE ON TACKLING OVERINDEBTEDNESS**

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## **1. EXECUTIVE SUMMARY**

- 1.1 From the outset the Task Force recognised that there needed to be a shared commitment to tackle overindebtedness. Lenders have a responsibility to provide consumers with clear and understandable information on a loan offer and to use their best endeavours to ensure that the borrower has the ability to repay the credit, along with their other financial commitments. Equally, consumers have to be responsible for managing their finances sensibly, and not taking on commitments that they are unlikely to be able to repay.
- 1.2 Neither borrowers nor lenders can foresee major changes in circumstances such as redundancy, serious illness or marital breakdown, all of which can and do turn previously manageable borrowing into overindebtedness. The Task Force saw it as essential that both borrowers and lenders make allowance for such possibilities.
- 1.3 The Task Force also noted a cultural change in society in recent generations from a 'save first, spend later' approach to one of 'borrow now and repay later'. Access to credit is something most consumers welcome and use sensibly. However, the 'borrow now and repay later' approach does place added responsibilities on borrowers and lenders.
- 1.4 Finally, the Task Force noted that issues can arise with all forms of credit, including secured and unsecured, fixed sum and revolving credit. It also recognised that problems of overindebtedness can be caused by factors other than the granting of credit, such as financial difficulties resulting from running up arrears with non-credit financial commitments such as rent, utilities, and council tax.
- 1.5 The Task Force identified that, with the exception of the OFT's 1989 report on overindebtedness and the PSI report in 1992 on credit and debt, there has been relatively little research on the extent and nature of overindebtedness. In addition, there is no generally accepted definition of overindebtedness, though one suggestion is that it is 'when income is insufficient to cover reasonable living expenses and meet financial commitments as they become due'. However, there was general agreement within the Task Force that overindebtedness was not confined to just being in arrears on one or more debts, and could include consumers with commitments bordering on the unmanageable.
- 1.6 Given the absence of recent detailed research in this area, the Task Force recommends that the Department should commission a detailed research study to build up a better understanding of the factors that lead consumers to become overindebted, and provide a basis for assessing the need for further measures to build on the recommendations of the Task Force. It should also examine the nature and extent of consumer debt.

1.7 The Task Force agreed there were a number of key issues that needed to be taken into account when making any recommendations on practical ways to tackle overindebtedness. These were:

- ❖ recognising the importance of proportionality in any proposed changes to lending practices
- ❖ ensuring the benefit to consumers in general outweighs the cost of change, and delivers the DTI's White Paper objectives of helping to create confident consumers and effective markets
- ❖ testing with representative groups of consumers whether the proposals are practical solutions to tackling overindebtedness and bring tangible benefits to consumers
- ❖ ensuring that any proposals for change do not create unintended effects or distortion of credit markets.

However, the Task Force identified that there were some steps that could be taken ahead of the results of the research study to ensure consumers were better informed and protected when taking out credit, and that could contribute towards reducing overindebtedness. One such step would be to improve the transparency of the way in which credit is marketed and provided so that consumers are able to make better, more informed decisions, and reduce the risk of them becoming overindebted.

1.8 There was also general agreement amongst the Task Force on the crucial role of consumer education, information and advice, and the need for greater emphasis to be placed on education as a longer-term means of addressing overindebtedness. It was agreed that for consumer education to be effective it required greater co-operation and co-ordinated action by Government Departments, regulators, consumer groups and lenders, and would benefit from one body, such as the Financial Services Authority (FSA), taking the lead.

1.9 It was also considered important that consumers should know the right questions to ask themselves and a prospective lender before entering into a credit agreement. In addition, consumers need to be encouraged to recognise the importance of financial management and the positive or negative impact that their actions can have on their credit record. The Task Force saw encouraging consumers to take an active responsibility for their credit file as part of the education process.

1.10 The growth in credit marketing arising from increased competition in the industry and the way credit is offered to consumers points towards a need for measures aimed at curbing misleading and/or irresponsible marketing techniques and literature. Key areas identified as contributing to potential consumer detriment were marketing material emphasising the possibility of untypically high credit limits, or giving the impression that 'easy' credit is readily available regardless of the borrower's circumstances.

- 1.11 Most major lenders who share data through the credit reference agencies share considerable amounts of positive as well as negative data. Some limit sharing solely to negative data. There has been a consistent trend towards sharing more data and there is a willingness in the lending industry to continue this trend, where the data is genuinely predictive. However, it is recognised that some lenders do not use positive data where they consider it is less predictive than other data available to them.
- 1.12 The Data Protection Act does not present a significant legal obstacle to the sharing and registration of relevant data, though it does require the consumer to give informed consent. This presents major difficulties where it would be necessary to obtain retrospective consent, as would be the case for some data. That could also mean that it could take some time before shared data reaches a sufficient 'critical mass' to be useful. In addition, the non-availability of data such as student loans, current account and overdraft details, income and other regular financial commitments like rent and utility costs (unless provided by the consumer) precludes a full picture of the borrower being available. It was also noted that changes to data sharing could require major developments in IT systems, to ensure the sharing of reliable data. It was concluded, however, that there were a number of areas where improvements in responsible lending could be achieved. These include:
- ❖ better credit scoring techniques
  - ❖ improving the information shared by lenders about credit card accounts to help them identify where a consumer is paying the minimum monthly amount only on an account with a consistently high balance, and
  - ❖ greater use of income and financial commitments data.
- 1.13 However, data sharing is complex and there are major issues around ensuring data quality and seeking existing customers' agreement. In addition, the changes to computer systems to achieve the transfer of data can be complex and costly, so it will take time to achieve these improvements. Data sharing carries a cost, which can have commercial implications in the context of smaller lenders and low value loans. Whilst being mindful of this, the Task Force encourages lenders to share a wider range of data on borrowers and also to use the data available to them more fully.
- 1.14 The provision of interest free option periods and low start interest agreements is a considerable benefit to consumers. However, there can be potential detriment to some consumers due to a lack of transparency and understanding at the time of taking out the agreement, and at subsequent key stages. The Task Force welcomes industry action by the Finance and Leasing Association (FLA), subsequently followed by the Consumer Credit Trade Association and the Association for Payment Clearing Services to give consumers prior notification of the end of the discounted period and a short grace period

for consumers who miss the deadline for paying the outstanding balance on interest free options.

- 1.15 In addition, the granting of unchecked instant credit – where no attempt is made to establish credit worthiness - was seen as contrary to responsible lending practices. Although this is a declining practice due to the ease with which credit scoring can now be undertaken, the Task Force welcomes the decision by the FLA to end this type of credit among its members.
- 1.16 The wider issue of greater transparency in the information provided to consumers by lenders requires more consideration and examination of the key issues, to ensure that changes are proportionate, represent clear benefit to consumers, and have been properly tested before implementation. However, a number of proposals have been considered in terms of ensuring that borrowers have the key information on a loan available to them before they sign; a more logical structure and approach to the completion and signing of the credit agreement; and the development of key rights and responsibilities for consumers. The Task Force expressed commitment to the strategic aim of greater transparency in these areas, but also the necessity of further work on the detail of any changes to ensure they are not disproportionate to the size of the loan and deliver clear benefits to consumers.

## **2. INTRODUCTION**

- 2.1 The Task Force on Overindebtedness was set up following a conference hosted by Dr Kim Howells, Minister for Consumer Affairs, last October to explore the causes and effects of overindebtedness and look at ways of achieving more responsible lending and borrowing.
- 2.2 The Conference was attended by representatives from the credit industry, the retail sector, the advice sector, and other parties with an interest in consumer debt, including Government Departments. The aim of the Task Force was to take forward a partnership of the public and private sectors and identify a number of practical measures for tackling overindebtedness. Dr Howells asked the Task Force to look at three specific and key areas:
- ❖ Improving the transparency of information provided to consumers before and when concluding a credit agreement, including the small print;
  - ❖ Adoption of core principles of lending practice, including examining an applicant's overall borrowing exposure and ability to repay; and
  - ❖ Requiring clear notification to consumers on free and low interest agreements before the final payment is made, or moving onto a repayment plan.
- 2.3 Dr Howells also wanted the Task Force to look at identifying how more responsible lending could be achieved through better sharing of information between lenders and greater transparency where consumers are declined credit. The terms of reference are set out at Annex A.
- 2.4 The Task Force membership was drawn from the British Bankers' Association (BBA), Consumer Credit Association (CCA), Council of Mortgage Lenders (CML), Experian, Finance and Leasing Association (FLA), Financial Services Authority (FSA), National Association of Citizens Advice Bureaux (NACAB), Office of Fair Trading (OFT) and the Personal Finance Research Centre (PFRC). In addition, a discussion group comprising other Government Departments and organisations represented at the conference has worked alongside the Task Force to provide a wider range of expertise, and feed suggestions into the Task Force as well as comment on emerging conclusions. The membership of the Task Force is set out at Annex B and that of the Discussion Group at Annex C.
- 2.5 Current evidence of overindebtedness presents a mixed picture. On the one hand, it is clear that the level of consumer borrowing has increased markedly in recent years. Figures from the Bank of England show that, in December 1997, the total amount outstanding in consumer credit (excluding mortgages) was £87.5bn. By December 2000 this had grown to £127.4bn – almost certainly fuelled by the buoyant economy and high levels of the 'feel-good' factor among consumers. Moreover,

NACAB statistics show a sharp increase in the number of enquiries (up 37% over the past two years to 592,423) received by CABx relating to debt problems. The biggest increase in enquiries for any problem over the past two years. On the other hand aggregate statistics show that the number of consumer credit accounts in arrears has remained at around 5 per cent for the past five years. In addition, there have been reductions both in the number of mortgages in arrears and the level of re-possession, and actions taken in county courts related to debt. More detailed information on levels of consumer borrowing, CAB enquiries, figures on arrears trends, and court actions are given at Annex F. It is not clear what the underlying reasons are for these trends. It could indicate that a growing number of consumers have borrowed excessively and, while they are not in arrears with their credit commitments, they are facing financial difficulties. Equally, it could indicate that levels of awareness and hence use of advice agencies are increasing without there being any underlying increase in the level of financial difficulty.

- 2.6 The work of the Task Force sits alongside a number of other current initiatives. These include:
- ❖ HM Treasury's statutory regulation of mortgages
  - ❖ FSA's developing consumer education role
  - ❖ FSA's development of information, disclosure and financial promotions requirements on mortgages in preparation for taking on mortgage regulation
  - ❖ Work by the FSA on the prudential implications of growing secured and unsecured debt
  - ❖ HM Treasury's promotion of credit unions, and the current consultation on credit union regulation by the FSA
  - ❖ The OFT's work on vulnerable consumers and non-status lending
  - ❖ The OFT's consultation paper on a new approach to consumer codes of practice
  - ❖ Reviews of the banking and mortgage codes
  - ❖ HMT's CAT standards for a range of financial products
  - ❖ OFT guidelines to consumer credit licensees and on unfair contract terms
  - ❖ OFT's debt awareness campaign and information for consumers
- 2.7 In addition, there have been a number of reports addressing the issue of extortionate credit, which remains a serious problem, particularly for more vulnerable consumers, and is a contributory factor to the problem of overindebtedness. The OFT reported on this issue in 1991 and 1999, Elaine Kempson of PFRC undertook research for the DTI in 1999, and last year NACAB published its report entitled '*Daylight Robbery*'. However, the Task Force was not asked to look specifically at the issue of extortionate credit.
- 2.8 Many of the principles set out in the OFT's Non-Status Lending Guidelines are of direct relevance to the work undertaken by the Task

Force. They include the need for transparency in all dealings with borrowers, adequate time for borrowers to reflect on the terms and conditions of a loan and no high-pressure selling, contract terms and conditions to be fair and written in plain English, and all lending decisions to be based on a proper assessment of the borrower's ability to repay.

- 2.9 The Department has continued its work in partnership with the Money Advice Trust aimed at ensuring consumers can have ready access to high quality, free and independent debt advice. This includes the recent matched funding with lenders for a £2million project to pilot a possible national infrastructure for independent and free money advice.

### 3. RESEARCH INTO THE CAUSE, EFFECT AND EXTENT OF OVERINDEBTEDNESS

3.1 Some research into overindebtedness is currently being undertaken by a range of organisations. The Task Force is aware of the following work:

- ❖ the OFT is analysing the Family Expenditure Survey to see how much is used for repaying borrowings and to update figures in its 1989 report
- ❖ the OFT and NACAB are undertaking a joint study on the causes of overindebtedness through a sample of CAB cases
- ❖ the Consumer Credit Counselling Service is analysing 12,000 of its cases
- ❖ a CML study with the Bank of England on the use of mortgage equity withdrawal
- ❖ the Credit Services Association is carrying out a survey of UK debt collection agents on levels of debt and practices
- ❖ the Welsh Consumer Council is working with NACAB and the Trading Standards Service to understand the cause and nature of debt in Wales.

3.2 The Task Force concluded that whilst these exercises would provide valuable information, there was an absence of recent and detailed research into the cause, effect and extent of overindebtedness amongst UK consumers. Such research would be a valuable aid in assessing the need for further measures to build on the recommendations from the Task Force and provide a baseline for determining whether they are proportionate and effective.

3.3 **The Task Force therefore recommends that:**

- ❖ **research should be commissioned by the DTI to build up a better understanding of the factors, both personal and external, that lead to consumers becoming overindebted. It should also examine the nature and extent of both secured and unsecured borrowing and the incidence of repayment difficulties, plus other debts that act as a contributory cause of overindebtedness. It should collate data on the type and size of consumer debt, and identify what actions by lenders and borrowers contribute to debt problems. It should also highlight any possible solutions to overindebtedness that arise from the research.**

3.4 A draft Invitation to Tender for the research is set out at Annex D. This research could be started in the early summer and is likely to take up to six months.

## 4. THE ISSUES

### Consumer financial education, information and advice

- 4.1 The case for consumer education rests on evidence that the level of understanding of financial matters amongst the population as a whole is limited. Mere factual information about a product, or a service, or a legal right, is not in itself enough to ensure that consumers are able to make appropriate decisions. Consumers need to develop the skills to manage their finances so that they minimise the risk of becoming overindebted; to identify their needs; to obtain information where relevant about competing products/services; and to evaluate one against another before they can make effective and informed choices appropriate for their needs.
- 4.2 A number of initiatives to improve financial education and skills are in place:

#### In schools

- ❖ Financial education and consumer rights and responsibilities, including education on budgeting, money management and debt, are now part of the school curriculum in Scotland, England and Wales, and inclusion is under discussion in Northern Ireland.
- ❖ The Personal Finance Education Group (pfeg), with support from the FSA, has developed a 'quality mark' system supported by the Department for Education and Employment (DfEE) and Qualifications & Curriculum Authority (QCA) to ensure that industry providers of educational materials meet the new curriculum needs for financial education resources. Many financial sector firms and other organisations are producing or adapting resources to fit the curriculum that meet the quality mark.
- ❖ The FSA, working with others such as the individual curriculum authorities for England, Scotland, Wales and Northern Ireland, Channel 4 and educational publishers, has produced and distributed a range of educational resources for children.
- ❖ Scottish local authorities are working in partnership with schools to provide staff to participate in ongoing programmes of consumer financial education, which is an entitlement in the Scottish curriculum
- ❖ The 'Young Scot' project is a charity that aims to give all Scottish 12-25 year olds information, opportunities and support in all aspects of their lives. The FSA provides the financial information, including that on credit and debt, contained within their publications.

#### For adults

- ❖ The FSA has a statutory duty to promote public understanding of the financial system and is developing a learning framework, educational programmes and material suitable for schools, adult and community education, further and higher education and the workplace.

- ❖ The National Consumer Education Partnership (NCEP) has developed a learning framework which covers general consumer education issues, and focuses on schools through to adult learning, consumer values and behaviour, and how decisions influence markets
  - ❖ The DTI has obtained European funding for some consumer education projects. These are being taken forward by the FSA, the Basic Skills Agency, and the Consumers Association, with support from other partners including the National Consumer Council and Trading Standards Departments.
  - ❖ The Basic Skills Agency has secured funding from DfEE to develop a programme and resources to improve the financial literacy of the adult population by giving socially excluded adults the knowledge and confidence to make informed judgements and effective decisions regarding their own finances. They are working on this project with the BBA, NACAB and Association of British Credit Unions Ltd (ABCUL).
  - ❖ In December last year the DfEE published the recommendations of the Adult Financial Literacy Advisory Group (ADFLAG), which called for the DfEE, the Basic Skills Agency and others to work with the FSA to ensure that its educational initiatives reach as wide an audience as possible. The DfEE's new Adult Basic Skills Strategy Unit was due to take the lead on following through the report's messages, in particular the link between low financial capability and poor literacy and numeracy.
  - ❖ Scottish local authorities are working with community groups on 'credit awareness' programmes; while other Scottish groups are involved in consumer financial education initiatives such as working with pre-release prisoners.
- 4.3 The Task Force welcomes the progress made at the schools level in integrating consumer and personal finance education into the national curriculum. Effective collaboration by a wide range of organisations working together has been crucial in making this happen. The Task Force believes similar collaboration is crucial at the adult level to ensure that programmes of financial education are developed and delivered effectively.
- 4.4 The Task Force also recognised the important role of clear and comprehensible information provided to consumers. The OFT produces a range of booklets and leaflets on consumer issues such as buying on credit, cancelling a credit agreement, and getting extra protection when using credit. It has also run publicity campaigns and 'consumer alerts' on specific issues such as credit repair. Private sector organisations have undertaken specific information projects, such as providing free financial education materials, and supported consumer education initiatives. In addition, the credit reference agencies have promoted a range of literature and website initiatives to explain credit referencing and why you may have been refused credit.
- 4.5 The Task Force welcomes these initiatives, but as the ADFLAG report and other research have shown, it remains the case that significant

numbers of adults lack the financial literacy to be confident consumers. In addition, it was recognised that there was scope for greater co-ordination of the private and public sector initiatives to ensure they are delivered to consumers in a targeted and effective manner.

4.6 The Task Force agreed that many consumers take out a loan without giving detailed consideration to key factors such as:

- ❖ can I afford this loan?
- ❖ how much will it cost me?
- ❖ how can I get the best deal? and
- ❖ will I still be able to afford it if my circumstances change?

In addition, when buying goods or services on credit the consumer is often so pre-occupied with decisions such as choosing the right television and getting it home, that they give less consideration to decisions about credit. As a consequence, the credit element becomes a means to purchase rather than part of the overall decision. Consumers need to consider whether buying on credit is best for their circumstances, and what kind of credit to use.

4.7 Much of this could be addressed through better consumer financial education, information and advice to encourage consumers to take time to consider their need for credit and the options available, and to ask the right questions to ensure that they secure the best deal when they need credit. Consumers know all their circumstances, including their income and commitments, and ought to be in the best position to make an assessment of their capacity to take on a loan, and if necessary resist credit offers from lenders. The purpose of good financial education is to give them the knowledge and skills to exercise such judgement properly.

### **Marketing techniques**

4.8 Marketing information, however delivered, contains information consumers will use before entering into an agreement. And in many cases, particularly with distance selling, marketing literature may be the major source of information to the consumer before concluding an agreement. This is particularly the case for direct mail credit card offers which typically include terms and conditions and an application form.

4.9 Marketing literature is a key information input designed to inform consumers about the product and influence them in choosing one brand over another. If marketing were not effective it would not be undertaken by lenders to the extent evident by its daily arrival on consumers' doormats.

4.10 The Task Force was particularly concerned about the targeting of loans at non-status or other vulnerable consumers, such as those with County Court Judgements (CCJs) and arrears, and also about high-

pressure selling by some brokers and intermediaries, and retail sales staff.

- 4.11 The Task Force identified a number of approaches or messages presented to consumers through marketing material that were not necessarily consistent with encouraging responsible borrowing or with responsible lending practice. These messages may be particularly dangerous when they are the headline in the advertisement. They include, suggesting that no questions will be asked in assessing an application, promoting unrealistically high credit limits, encouraging consumers to ask for a higher loan than they may actually need, lots of small print, and unsolicited credit offers such as blank cheques drawn on a credit card account. Such approaches can encourage consumers already struggling to assume that further credit is easy, and mislead or discourage them from properly considering the offer before making a decision.
- 4.12 The Task Force also observed an overt trend in marketing towards emphasising the ease, speed and scale of credit availability, and offering incentives and inducements to borrow. Presenting a picture that there is lots of easy money to be had is misleading and runs counter to the message that borrowing needs to be thought about, earned and repaid. It is particularly important that advertising messages do not negate the messages being put across in consumer financial education initiatives aimed at those unfamiliar with credit.

#### **Transparency of information and content of agreements**

- 4.13 The Task Force considered the importance to consumers of information prior to entering into a credit agreement. In order for consumers to be able to judge whether they can afford a loan and whether or not they should take out a particular type of credit, there must be meaningful information that readily enables them to understand the key features of the credit offer, decide whether they can afford it, and compare it with others. The Consumer Credit Act requires certain information to be provided to consumers in regulated agreements and certain kinds of credit advertisement, and that should allow them to decide whether or not they can afford to take on a debt. However, it may be possible to provide this information in a more user-friendly form that encourages consumers to think carefully and compare offers before signing.
- 4.14 A key consideration in providing any information to consumers is a recognition that it needs to be done in a way that facilitates, and does not unnecessarily delay or hinder, the transaction the consumer is undertaking. While an opportunity for the consumer to pause and reflect on an offer may be desirable in his or her longer-term interests, there is a balance to be struck between speed and efficiency of transactions, and adequate consumer protection.

- 4.15 The Task Force examined the current format of regulated credit agreements. While agreements contain much valuable information for the consumer and lender, they can be very detailed, and this can lead to confusion and misunderstanding by the consumer. The content and format of agreements is constrained to some extent by regulations, but some of the problems arise from the inclusion of additional terms in the agreement, the language of those terms, and the format and layout of the documents. The Task Force recognised that some lenders, as part of their best practice approach, have tackled the 'small print' issue through the highlighting of key terms and using simpler language, including gaining a crystal mark for the text in some cases. However, others have agreements in which the text is often very small, detailed and very legalistic, with only variable attempts to alert consumers to their key rights and responsibilities. This is despite the requirements of the Unfair Terms in Consumer Contracts Regulations that require that contract terms should be expressed in plain, intelligible language. Agreements concluded in some circumstances, particularly busy environments such as retail stores, can leave consumers feeling they have had inadequate time to read the agreement and seek any clarification. The Task Force also recognised that some consumers may just want to sign and get home with the goods they are purchasing.
- 4.16 Many lenders provide Payment Protection Insurance (PPI) as an optional benefit to consumers, but it is sold as an integral part of the credit package. In the right circumstances, PPI can provide valuable protection against changes in a consumer's financial circumstances, which might lead to overindebtedness. However, despite recent improvements in sales practice, there is evidence to suggest that consumers are sometimes sold PPI without them being fully aware that it is optional, and more disturbingly where their circumstances, such as being self employed or with long term health problems, might be specifically excluded from cover. Inertia selling of PPI and inappropriate marketing practices may be encouraged by the levels of commission payable to the sellers. The Task Force was concerned to find ways of preventing the mis-selling of PPI without discouraging its take-up by those for whom it can provide protection.

### **Core principles of lending practice**

- 4.17 The Task Force considered whether there were core principles of good lending practice that all lenders should adopt. The principles considered by the Task Force included examining a borrower's overall commitments, their ability to repay, using all available shared positive and negative data, and the need for borrowers to understand fully the implications of switching from unsecured lending to a secured loan.
- 4.18 The Task Force recognised that the Data Protection Act requires lenders to hold only information that has been fairly obtained, and to use it only for the purposes for which the data subject had given

consent. The Task Force also recognised that in some circumstances consumers could be reluctant to provide detailed personal information and that to insist that they do so might change their decisions about the type of credit they wished to use.

- 4.19 Although this part of the Task Force's work concentrated on lenders and their use of the information available about borrowers, the Task Force recognised that only the borrower had complete knowledge of his or her circumstances and so had a responsibility to consider very carefully whether or not he/she could safely take on a debt.
- 4.20 Income and existing commitments, including non-credit ones such as rent and utility bills, as well as general housekeeping, are also factors in determining the borrower's ability to repay further credit. Consumer representatives on the Task Force considered income compared to all financial commitments would also be an important predictor of a consumer moving towards possible overindebtedness.
- 4.21 However, lender representatives considered that income and commitments were only two of a number of factors that could be taken into account. Some other factors may be more predictive of the likelihood of the consumer getting into difficulties; and in some cases lenders have substitute data for income and commitments.
- 4.22 Clearly on income and commitments there are questions of proportionality. Lenders must act reasonably in obtaining and assessing information about a potential borrower's circumstances. This is particularly important in relation to secured lending where the borrower's home is at risk. While it is less relevant for small, unsecured loans the lender must still act responsibly and have proper regard to ability to repay; and for vulnerable consumers or those on low incomes the margin between successful financial management and overindebtedness can be much narrower.
- 4.23 The Task Force identified that there is no obligation either legally or otherwise on lenders to share or register data. Likewise, within the constraints of the Data Protection Act, there is no legal obstacle to lenders sharing relevant positive and negative data, though consent from the data subject is required in advance. Positive (or full) data shows in detail how a credit account has been managed. It includes the credit limit if applicable, the balance and payment history, i.e. whether contractual payments have been made on time or not. Negative (or limited or delinquent) data records only arrears or default history relating to a credit account. Data sharing through the credit reference agencies is controlled (as well as by legislation) by the Principles of Reciprocity – administered by the Standing Committee on Reciprocity (SCOR) – which address such issues as commercial sensitivity (enabling data sharers to be confident that shared data may not be used by competitors to poach customers or for marketing purposes) and quality of data. Accuracy and currency of data is also

specifically dealt with by the Data Protection Act, as are such issues as how shared data should be accessed by consumers and how and when lenders should mark an account as in default. Some data, e.g. current bank account data, is traditionally not shared because it can contain particularly sensitive information about customers. Consent has not been sought for this up until now, and product differences result in the data being considered by the banks to be too volatile to provide reliable indications of financial status.

- 4.24 Many lenders now use positive as well as negative data when considering an application for credit. The use of negative only data is appropriate when identifying consumers already in some financial difficulty. The value of positive data is that it can be used to indicate that a consumer has not yet reached but is moving towards an overindebted situation (or conversely to positively indicate an ability or likelihood to pay). The Task Force agreed that greater emphasis could be placed on the use of positive data, unless lenders already have other data that can indicate impending overindebtedness. As credit reference agency data does not include other, non-credit financial commitments or details of income, these – if required by the lender – have to be obtained at the point of application from the consumer.
- 4.25 The issue of proportionality and convenience to consumers of requiring additional information needs to be balanced against the potential benefits of a more informed lending practice. A balance also needs to be struck between the size of the borrowing and the requirement on consumers to provide such information. Another factor is a possible skewing of the market towards revolving credit, such as credit cards, where such information has only to be provided once by the customer over the lifetime of the card.

#### **Interest free options, low start interest agreements and credit cards**

- 4.26 The Task Force explored the established practice, particularly within the retail sector, of offering consumers buying goods on credit or transferring to a new credit card provider an interest free option period or low start interest agreement. In the case of interest free options products, consumers have the option at the end of the interest free period of either repaying the outstanding balance in full or continuing with an interest bearing repayment programme, with interest backdated to the start of the loan. Many consumers sensibly take advantage of this type of offer, even if they can afford to pay for the goods in full at the outset. However, some through a lack of transparency or understanding of the agreement, or through simple forgetfulness, do not pay off the balance at the end of the interim period. As a result they find themselves unexpectedly incurring higher interest or in a long-term repayment programme, usually at a high APR, at the end of the initial interest free period.

- 4.27 Without reducing the opportunity for consumers to take advantage of these offers, the Task Force considered there was scope to improve transparency, not just at the time the agreement is entered into, but prior to and at key stages in the life of the agreement. Also, that these improvements should not be confined to the retail sector, but should apply to other sources of credit such as personal loans, credit cards, store cards, etc.

#### **Unchecked instant access to credit**

- 4.28 The provision of unchecked instant credit is used by some retail stores, though this is a declining practice and a small market. This is where a consumer is offered credit, often at the point of sale and with an associated discount on the goods being purchased, but no attempt is made to establish the credit worthiness of the borrower. Most lenders reduced the level of credit available in this way to no more than £1,000 in June 1998 and have since imposed tighter controls as electronic credit verification has become much quicker.

#### **Reasons for credit refusal**

- 4.29 The Task Force considered whether there was a need for improved transparency on the part of lenders where consumers are declined credit, and whether this could play a part in minimising overindebtedness. While many lenders have procedures that clearly spell out to a consumer the reason he/she has been declined credit, others do not and particularly so if the refusal is a concern over the ability to repay the loan. Where a lender has declined an application for this reason the Task Force considered that a clear statement could contribute to discouraging consumers from approaching other lenders or approaching so-called credit repair companies. However, lenders feared that it could also lead to some consumers simply using that information to 'massage' applications to other lenders.
- 4.30 More openness about reasons for refusal could also help to engender a culture of consumer ownership of their credit record and contribute to consumers being able to avoid behaviours and actions that could have a negative impact on their ability to borrow in the future.

## 5. PROPOSALS FOR CHANGE

### Consumer Education, information and advice

#### Consumer Financial Education

- 5.1 The Task Force recognised that in order for consumers to understand properly the information they are given when buying financial products and services they need to better understand their rights and responsibilities as consumers. This requires better financial education both for young people in schools and for adults. The Task Force also recognised that although it is not a statutory part of the curriculum, co-ordinated work is underway to achieve better financial education in schools. There is also a smaller body of less co-ordinated, though valuable, work on adult education.
- 5.2 The Task Force concluded that the way forward was through the development of a mapping exercise aimed at defining the level and scope of consumer financial education currently being delivered, and to identify good practice. A co-ordinating body for developing policy and implementation needs to be set up which can build on the findings of the mapping exercise.
- 5.3 The Task Force also considered the role consumers can play in taking positive action to 'manage' their credit record. Many consumers have little or no knowledge of their credit record or the impact that particular actions can have on it. Consumers tend only to seek a copy of their credit file when they have been declined credit or have been alerted to a potentially damaging statement on it. Few are aware that some actions, such as frequent credit searches, can have a negative impact on their overall credit standing.
- 5.4 It was agreed that as part of a consumer financial education plan consumers should be encouraged to take a greater interest in their credit record, and be aware of the actions that can have a positive or negative impact on it.
- 5.5 **The Task Force recommends:**
- ❖ **that the FSA should play a more active role in promoting and co-ordinating adult financial education on consumer credit by working with the DTI, DfEE, and other interested parties such as the Scottish Executive, to:**
    - ❖ **undertake a mapping exercise of current adult consumer financial education as it relates to money management, and**
    - ❖ **establish a co-ordinating body with responsibility for developing policy and effective practice in adult consumer financial education, by the end of 2001**

- ❖ **that wherever relevant Government policy should take into account links between key employment skills and key consumer life skills**
- ❖ **that through the education process (in both schools and for adults) consumers are enabled and encouraged to take responsibility for the management of their finances and a positive approach to their credit record.**

## **Information and Advice**

- 5.6 The Task Force recognised that alongside education stands a need for consumers to have ready access to information and advice when they are thinking about using credit. This would assist them in asking the right questions, including helping them to assess their capacity to borrow, and also help them clarify and use to their advantage the information they are given, such as the Annual Percentage Rate (APR) and different forms of credit.
- 5.7 The DTI's Consumer Support Networks (CSNs) programme was identified by the Task Force as an appropriate way of creating a national infrastructure of financial information and advice, and would supplement existing financial information providers such as the OFT and FSA. It was recognised, however, that there were resource implications for Trading Standards Departments and others in taking this forward.
- 5.8 **The Task Force recommends that:**
- ❖ **that the DTI's Consumer Support Networks should be utilised to provide a national infrastructure of financial information and advice**
  - ❖ **that the DTI explore with LACOTS and other organisations how CSNs might be developed and resourced to fulfil this role**

## **Key questions for consumers when taking out a loan**

- 5.9 In addition, the Task Force concluded that consumers should be encouraged to ask themselves a set of questions when considering taking out a loan, and then another set to ask the prospective lender. These questions were aimed at ensuring that the potential borrower asked whether he/she really needed a loan and could he/she afford it, and then to help him/her identify the best and most appropriate deal.
- 5.10 It was agreed that consumer groups, lenders and Government had a role in promoting the provision of these questions.
- 5.11 **The Task Force recommends that:**
- ❖ **a DTI working group should finalise by the end of October 2001 a set of key questions, such as those at Annex E, for**

**consumers when taking out a loan and it should be made available through CSNs, consumer groups, lenders, Government, etc. Consideration should also be given as to whether there should be separate 'key questions' for different market sectors or types of credit.**

**Marketing techniques:**

- 5.12 The Task Force agreed that there was an overt trend in the marketing of credit towards emphasising the ease, speed and scale of credit available to consumers. It was recognised that for most consumers this presented no problems. However, there was a concern that this trend ran counter to messages about responsible lending. While some of the concerns over marketing techniques are specific issues for OFT (and in the future FSA) to consider and where appropriate take action, others appear to be outside the scope of specific regulation.
- 5.13 The Task Force concluded that inappropriate and unhelpful marketing techniques could be curbed by an industry code of best practices. It could also help ensure a level playing field for those lenders who do not resort to these inappropriate and unhelpful practices. However, a code could only be as effective as its coverage. The Task Force agreed that OFT should take the best practices and ensure they are incorporated in any codes it endorses, as well as in any guidance material it issues on licensing.
- 5.14 **The Task Force recommends that:**
- ❖ **all relevant trade associations should either agree a general code of practice on marketing credit, or develop their existing codes, to cover best practices by no later than March 2002.**
  - ❖ **while any advertisements falling within the Consumer Credit Act should be in line with the requirements of the Advertising Regulations, the best practices would include:**
    - ❖ **not emphasising the possibility of high credit limits that are unlikely to grant**
    - ❖ **not giving the impression that there is easy credit readily available to anyone**
    - ❖ **where speed of decision making is a feature of the advertisement, making clear that this will not be at the expense of a proper assessment of the applicant's ability to repay**
    - ❖ **making the main terms and conditions clear**
    - ❖ **making the limitations on any special offers as clear as the offer itself**
    - ❖ **encouraging consumers to fully consider whether they can afford the repayments before making an application, including the need to consider how they would cope with a change in circumstances – this could include the provision of a budget planner**

- ❖ clear warnings that a failure to repay could damage their credit record
- ❖ a DTI working group should examine further the sending of unsolicited pre-approved loan, credit card cheques and overdraft offers that do not need to be positively accepted by the borrower, and report by no later than end December 2001
- ❖ Trade Associations should review codes regularly to make sure they are up to date with developments in the market place and continue to both reflect and deliver best practice
- ❖ OFT should ensure relevant principles of marketing best practice are included when endorsing credit industry codes of practice, and that there is adequate monitoring and enforcement by the code sponsor
- ❖ OFT should include relevant principles on best practice, where appropriate, in any guidance material it produces on credit advertising or the licensing regime
- ❖ The Advertising Regulations should be reviewed in the light of mortgage regulation to ensure they provide a consistent approach, and that they are targeted and effective.

#### **Provision of information prior to concluding a credit agreement**

- 5.15 The Task Force agreed that the provision of appropriate information to consumers at the time of taking out a loan should enable them to decide whether or not they could afford it, as well as compare offers and make informed decisions. While it was recognised that most lenders will seek to explain fully the terms of a loan to the consumer, it was agreed that there was scope for greater transparency and the presentation of clearer information before and at the time of signing a credit agreement.
- 5.16 The Task Force concluded that consumers should receive certain key financial information that helped them assess affordability, and enabled comparison and understanding about the credit terms before signing an agreement. This would enable them to consider and compare different forms of credit, and improve understanding, before making a financial commitment. This information, to be provided in writing or another durable form, would include details of the type of credit, the total cost of the credit, the APR, the frequency and number of repayments, and the amount of each repayment. This approach is consistent with the work the FSA is currently undertaking on the provision of key information to consumers when they are considering taking out a mortgage.
- 5.17 This information would be consistent also with the current requirements of the Consumer Credit Act, but the Task Force believes that it could be presented in a more user-friendly way, to aid consumer understanding, while not placing an additional burden on lenders.
- 5.18 It was also agreed that this information should be provided as the first part of a three-step approach to the provision of credit. The first step

would be the provision of key financial information that the consumer needs to consider before entering into an agreement. The second step would be completing the application form to provide the lender with the information needed to determine whether to offer credit, and the third step would be the decision by the lender and the signing of the agreement. This should enable the consumer to pause at the end of the first step to reflect on whether he/she can afford the credit deal, before completing the full application and having it considered by the lender.

- 5.19 The Task Force recognised that further work would be necessary on this proposal to see how it would work for the different types of credit offered. For example, it may not always be necessary for the first step to include producing personal quotations – use of standard tables might suffice.
- 5.20 The Task Force considered how the standard approach could operate in practice at certain types of point of sale, such as a retail store on a Saturday afternoon. It was concluded that a revision to the current layout of a regulated credit agreement form would probably enable this three-step approach to be achieved with little delay or disruption to the sales process.
- 5.21 **The Task Force recommends that, with the exception of first charge mortgages (which will be regulated by the FSA and have separate information requirements):**
- ❖ **all lenders should be required to provide certain key financial information in a clear and understandable format to the consumer so that he/she can see if they can afford it, as well as compare and understand the offer, before entering into a credit agreement.**
  - ❖ **the DTI sets up a further working group to explore how this should be implemented, and to examine whether the process of offering credit should form a three-step approach; key information; personal details; and then signing the agreement. It would look at whether a proportionate, but credit neutral approach could be adopted, as well as the costs and benefits. It would also examine whether this process could be achieved with a single document.**
  - ❖ **The working group should also review the current post contractual cancellation rights to ensure they would continue to provide appropriate consumer protection**
  - ❖ **any proposals from the working group should be tested on representative consumers to ensure they deliver the objectives**
  - ❖ **this work should be completed by April 2002.**

## **Improvements to the layout and content of credit agreements**

5.22 In respect of the form and content of the credit agreement there is scope for improvement, both on the face of the agreement document and the supporting 'small print'. The Task Force concluded that there was benefit in a fresh examination of the content of the agreement. Consumers would benefit from a standardisation of much of the content of the agreement, where this was feasible. While it was agreed that a single, standardised form could not meet the requirements of the many diverse ways in which credit is offered in today's market, consideration should be given to a standardised layout of certain key financial information.

5.23 **The Task Force recommends that:**

- ❖ **the working group on provision of prior information should also look at revising the content and form of the credit agreement to ensure it is clear and transparent to consumers, reflects the type of credit being offered, and that proportionality is taken into account.**
- ❖ **it should also consider how best to ensure that the 'small print' focuses clearly on the main rights and responsibilities of the consumer, explains the key terms, and is in plain language. This should include consideration of model clauses, a minimum font size, adequate colour differentiation between the typeface and the background to enhance readability.**
- ❖ **the proposals, which may require some changes to the current regulations on the form and content of agreements, should be tested on representative consumers to ensure they deliver the objectives**
- ❖ **this work should be completed by April 2002.**

## **Payment Protection Insurance**

5.24 There was general agreement within the Task Force that Payment Protection Insurance (PPI) can provide an important and valuable protection for consumers should they find that their circumstances change during the period of the loan, such as redundancy or illness and be unable to keep up repayments. However, it is clear that in some cases PPI has been sold to consumers who have failed to understand the product or even appreciate that it is optional. More damaging, is where it has been sold to consumers who do not satisfy the qualifying criteria, and therefore would be unable to make a claim. At the same time there was a concern amongst the lenders that separating PPI from the credit agreement might lead to fewer consumers taking it up, with consequent loss of protection against unforeseen changes in circumstances.

5.25 One possible improvement considered by the Task Force is that the consumer should be required to sign a second part of the credit agreement to show that they want PPI, and that the cost is included next to the signature. This would avoid cases where PPI was included without the consumer's explicit consent. However, the Task Force was unable to reach a conclusion on this proposal. It is clear that further consideration is required on how PPI is sold.

5.26 **The Task Force recommends that:**

- ❖ **further work is undertaken by another DTI led working group to establish how to overcome any mis-selling of PPI while still maintaining a high take-up amongst consumers who could benefit from it. It should report by the end of 2001.**

### **Adoption of core principles of lending practice**

5.27 The Task Force concluded that there were a number of areas where improvements in responsible lending could be achieved.

#### **Examining ability to repay:**

5.28 The Task Force agreed that lenders had a responsibility for making an assessment of the borrower's ability to repay before making a loan. Equally, consumers have a responsibility for considering whether they can afford to repay a loan before taking it out. The Task Force's proposals on consumer education, information and advice and on transparency of information are intended to help provide consumers with the tools they need to make that assessment.

5.29 The Task Force concluded that there was scope for improvement in the assessment by lenders of ability to repay. There are different ways of accessing the necessary information and carrying out the assessment, for example through home visits, collecting the information direct from consumers or by using credit reference agencies. The most appropriate approach and techniques for any particular case will depend on the nature of the lenders' business and the size of the loan.

5.30 Where only credit scoring based on data held by credit reference agencies is used, account should be taken of the borrower's current commitments to ensure that credit is not granted where it is likely to cause over-indebtedness. Credit scorecards are very effective at predicting the likelihood of repayment, but they do not focus specifically on 'ability to pay'. One reason is that data about the borrower's non-credit financial commitments is not available to lenders through the credit reference agency. Another is that the current detail shared by lenders relating to revolving credit accounts (i.e. storecards and credit cards) does not differentiate between 'full balance payers' and 'minimum amount payers'.

5.31 In addition, while some lenders have access to other data that may provide information on the applicant's income and existing commitments, a very small minority just focus on whether there is any negative data on a credit reference file. This means that ability to repay is not always taken fully into account when making a lending decision. Neither is the applicant provided with a clear 'affordability trigger' to consider the cost of the loan in relation to his/her income and existing commitments.

5.32 **The Task Force recommends that:**

- ❖ **lenders continue to invest in the development of more sophisticated scoring techniques to better identify over-commitment**
- ❖ **lenders who use credit scoring should consider during the development of decision systems making use of all available data to assess ability to repay**
- ❖ **lenders who do not use any form of data on income and existing commitments should be encouraged to do so**
- ❖ **where lenders are concerned that information on income and commitments provided by potential borrowers or their agents may not be reliable, lenders may wish to alert applicants that providing false or misleading information could lead to prosecution.**

**Sharing data:**

5.33 The Task Force recognised the improvements in data sharing that had occurred under the Principles of Reciprocity administered by SCOR. In addition, the Task Force accepted that the requirements of the Data Protection Act meant that data could not be collected on a wide scale on a contingency basis that these individuals might one day apply for credit. It also noted the decision by the Information Commissioner to restrict lenders' access to and use of third party data.

5.34 **The Task Force recommends that:**

- ❖ **where appropriate, lenders should seek to share all currently permissible data, both positive and negative, with other lenders. This should include outstanding credit balances, credit limits, open credit lines, history of repayments and amounts borrowed**
- ❖ **credit reference agencies and lenders jointly consider whether there are any changes to data sharing that could assist in more effective identification of over-commitment, especially on credit card limits, usage and repayment behaviour**

- ❖ **SCOR should publish plans to continue to develop data sharing, and consult with consumer groups and the Information Commissioner by the end of March 2002**
- ❖ **all non-credit organisations taking regular payments from consumers are encouraged to register those payment commitments and defaults with CRAs, if and when they have the necessary consent from consumers.**

## **Student loans**

5.35 The Task Force identified that the un-availability of data on student loans meant lenders were unable to build a complete picture of a borrower's existing commitments. Given that under the current student loans scheme repayment is income contingent the absence of this information could have a significant impact on the lender's ability to assess an applicant's ability to repay. The Task Force's earlier recommendations encourage lenders to share all permissible positive data in order to assess an ability to repay, but the absence of student loan information - along with data on other financial commitments – makes this difficult. However, the Task Force recognised that student loans are an entitlement to all eligible students and that action which could have the unintended consequence of diminishing their uptake should be avoided.

5.36 **The Task Force recommends that:**

- ❖ **DTI Ministers should press DfEE Ministers to make information about student loans available through credit reference agencies once students have completed their courses.**

## **Notification procedures and transparency on interest free option periods, low start interest agreements and credit cards**

5.37 The Task Force concluded that the way in which credit cards and loans with an interest free option period or low start interest are offered to consumers and administered could give rise to confusion or misunderstanding over the structure of the deal. It could also result in consumers inadvertently continuing with an interest bearing repayment programme at the end of the interest free period.

5.38 The Task Force welcomed the approach taken by the FLA to address possible consumer detriment in relation to interest free options products sold in retail outlets. The FLA now requires those of its members active in that market to remind consumers towards the end of the interest free period of the consequences of not settling the outstanding balance by the due date, and also to provide a short grace period for those consumers who inadvertently miss the deadline by a few days.

- 5.39 The Task Force also concluded that the application form for the credit should be explicit in detailing the type of credit agreement and payment arrangement being offered.
- 5.40 The Task Force understands that other sectors of the credit industry, such as the CCTA and APACs, support the FLA approach and are prepared to consider adopting a similar line for interest free options and low start interest agreements. The procedures for future regulation of mortgages with low start interest periods are being considered as part of the development of pre-sale notification procedures by the FSA.
- 5.41 The Task Force recommends that all lenders offering interest free option periods and low start interest agreements should:**
- ❖ **provide clear and explicit information on the credit agreement form about the type of credit being offered and the payment arrangements**
  - ❖ **clearly notify to consumers towards the end of the interest free option or low interest period and provide a short grace period for late payment of the outstanding balance**
  - ❖ **that the Trade Associations should monitor the effectiveness of this approach and review it in a year's time.**

Almost all major lenders belong to one or more of the industry trade associations but there are a few which do not. There may be scope for OFT to issue guidance on these products, which would apply to all lenders, whether or not they are members of trade associations.

### **Unchecked instant credit**

- 5.42 The Task Force welcomes the commitment by the FLA that its members will cease offering unchecked instant credit from 01 May 2001.
- 5.43 The Task Force recommends that:**
- ❖ **all lenders should adopt the undertaking by the FLA to ban unchecked instant credit.**

### **Reasons for credit refusal**

- 5.44 The Task Force concluded that where an application for credit is refused, the lender should give the applicant the main reason for refusing credit in accordance with the ***Guide to Credit Scoring 2000***, drawn up by the credit industry, in consultation with the OFT and the Information Commissioner. The Guide states that:

*“Where an application is declined, the lender will provide a clear explanation of the principal reasons for the decline...”*

#### 5.45 The Task Force recommends that:

- ❖ all lenders, whether they use credit scoring or not, should be as clear and specific as possible in communicating reasons for refusal of credit.
- ❖ lenders should ensure compliance with the Guide to Credit Scoring.

#### Other issues

5.46 **Secured lending ‘explanatory’ form** - The Task Force was concerned that some consumers take out a consolidated loan in order to reduce their monthly outgoings, often secured on their property, without understanding that an implication of a secured loan is that if they default their home could be at risk of re-possession. The Task Force agreed that while debt consolidation could be beneficial for some consumers this was not always the case, and there was concern that the significance of the change in the type of lending might not be fully appreciated or explained to all borrowers. The Task Force considered the possibility of consumers being required to sign an ‘explanatory’ form when taking on a secured loan that explained the loan arrangement and potential consequences of default, to supplement the existing ‘wealth warning’ on documentation. However, there were concerns that this could in practice lead to consumers waiving their rights without having understood them properly.

5.47 In the time available, the Task Force was unable to reach a conclusion on how best to address this issue. **The Task Force therefore recommends that:**

- ❖ a DTI working group should consider how best to ensure that consumers fully understand the implications of transferring unsecured borrowing to a secured loan and make recommendations by October 2001.

5.48 **Money advice** – The Task Force recognises the importance of ensuring that consumers who do get into debt problems should have ready access to sound, high quality debt advice. The marketplace has seen recently a rapid growth in fee charging debt management companies. Many consumers have been drawn to their services due to high profile advertising and ease of access. The Task Force considers it essential that all consumers have the option of free, independent money advice. Currently this is provided by a range of free advice services, many of which benefit from the fund-raising and training provided by the Money Advice Trust, and which have difficulty in meeting the demand for their services. The Task Force concluded that greater emphasis needs to be placed by Government and lenders on the development and adequate funding of the free advice sector. It therefore welcomed the financial support that creditors had provided to

the funding of the pilots for a national infrastructure of telephone based debt advice.

**5.49 The Task Force recommends that:**

- ❖ **the DTI in partnership with the Money Advice Trust, providers of free money advice and all credit grantors, should continue to develop a national infrastructure that results in the ready availability of free debt advice throughout the UK.**

**Debt Management Companies**

5.50 The Task Force considered the concerns being raised by both consumer organisations and lenders about the practices of some debt management companies, and the possible overindebtedness implications for consumers. The Task Force considered that some of these practices, especially some of the advertisements, could encourage irresponsible borrowing by encouraging people to think that contractual repayments can be avoided without any adverse consequences. The Task Force decided not to pursue this issue because the OFT is seeking evidence from consumers on their experiences of dealing with debt management companies, and from trade bodies and consumer organisations.

## **6. SUMMARY OF RECOMMENDATIONS**

### **Research into the cause, effect and extent of overindebtedness**

Research should be commissioned by the Department to build up a better understanding of the factors, both personal and external, that lead to consumers becoming overindebted. It should also examine the nature and extent of both secured and unsecured borrowing and the incidence of repayment difficulties, plus other debts that act as a contributory cause of overindebtedness. It should collate data on the type and size of consumer debt, identify what actions by lenders and borrowers contribute to debt problems. It should also highlight any possible solutions to overindebtedness that arise from the research.

### **Consumer Education**

The FSA should play a more active role in promoting and co-ordinating adult financial education on consumer credit by working with the DTI, DfEE, and other interested parties such as the Scottish Executive, to:

- ❖ undertake a mapping exercise of current adult consumer financial education as it relates to money management, and
- ❖ establish a co-ordinating body with responsibility for developing policy and effective practice in adult consumer financial education, by the end of 2001

Wherever relevant Government policy should take into account links between key employment skills and key consumer life skills.

Through the education process (in both schools and for adults) consumers should be enabled and encouraged to take responsibility for the management of their finances and a positive approach to their credit record

### **Information and Advice**

The DTI's Consumer Support Networks should be utilised to provide a national infrastructure of financial information and advice

The DTI to explore with LACOTS and other organisations how CSNs might be developed and resourced to fulfil this role.

### **Key questions for consumers when taking out a loan**

A DTI working group should finalise by the end of October 2001 a set of key questions, such as those at Annex E, for consumers when taking out a loan and it should be made available through CSNs, consumer groups, lenders, Government, etc. Consideration should also be given as to whether there should be separate 'key questions' for different market sectors or types of credit.

## **Marketing Techniques**

All relevant trade associations should either agree a code of practice on marketing credit, or develop their existing codes, to cover best practices by the end of March 2002.

While any advertisements falling within the Consumer Credit Act should be in line with the requirements of the Advertising Regulations, the best practices would include:

- ❖ not emphasising the possibility of high credit limits that they are unlikely to grant
- ❖ not giving the impression that there is easy credit readily available to anyone
- ❖ where speed of decision making is a feature of the advertisement, making clear that this will not be at the expense of a proper assessment of the applicant's ability to repay
- ❖ making the main terms and conditions clear
- ❖ making the limitations on any special offers as clear as the offer itself
- ❖ encouraging consumers to fully consider whether they can afford the repayments before making an application, including the need to consider how they would cope with a change in circumstances – this could include the provision of a budget planner
- ❖ clear warnings that a failure to repay could damage their credit record

A DTI working group should examine further the sending of unsolicited pre-approved loan, credit card cheques and overdraft offers that do not need to be positively accepted by the borrower, and report by no later than the end of December 2001.

Trade Associations should review codes regularly to make sure they are up to date with developments in the market place and continue to reflect and deliver best practice

OFT should ensure relevant principles of marketing best practice are included when endorsing credit industry codes of practice, and that there is adequate monitoring and enforcement by the code sponsor.

OFT should include relevant principles on best practices, where appropriate, in any guidance material it produces on credit advertising or the licensing regime.

The Advertising Regulations should be reviewed in the light of mortgage regulation to ensure they provide a consistent approach, and that they are targeted and effective.

## **Provision of information prior to concluding a credit agreement**

With the exception of first charge mortgages (which will be regulated by the FSA and have separate information requirements):

- ❖ all lenders should be required to provide certain key financial information in a clear and understandable format to the consumer so that he/she can see if they can afford it, as well as compare and understand the offer, before entering into a credit agreement.
- ❖ the DTI sets up a further working group to explore how this should be implemented, and to examine whether the process of offering credit should form a three-step approach; key information; personal details; and then signing the agreement. It would look at whether a proportionate, but credit neutral approach could be adopted, as well as the costs and benefits. It would also examine whether this process could be achieved with a single document.
- ❖ the working group should also review the current post contractual cancellation rights to ensure they would continue to provide appropriate consumer protection
- ❖ any proposals from the working group should be tested on representative consumers to ensure they deliver the objectives
- ❖ this work should be completed by April 2002

### **Improvements to the layout and content of credit agreements**

The working group on provision of prior information should also look at revising the content and form of the credit agreement to ensure it is clear and transparent to consumers, reflects the type of credit being offered, and that proportionality is taken into account.

It should also consider how best to ensure that the 'small print' focuses clearly on the main rights and responsibilities of the consumer, explains the key terms, and is in plain language. This should include consideration of model clauses, a minimum font size, adequate colour differentiation between the typeface and the background to enhance readability.

The proposals, which may require some changes to the current regulations on the form and content of agreements, should be tested on representative consumers to ensure they deliver the objectives

This work should be completed by April 2002

### **Payment Protection Insurance**

Further work should be undertaken by another DTI led working group to establish how to overcome any mis-selling of PPI while still maintaining a high take-up amongst consumers who could benefit from it. It should report by the end of 2001

### **Adoption of core principles of lending practice**

#### **Examining ability to repay**

Lenders should continue to invest in the development of more sophisticated scoring techniques to better identify over-commitment

Lenders who use data scoring should consider during the development of decision systems making use all available data to assess ability to repay

Lenders who do not use any form of data on income and existing commitments should be encouraged to do so

Where lenders are concerned that information on income and commitments provided by potential borrowers or their agents may not be reliable, lenders may wish to alert applicants that providing false or misleading information could lead to prosecution.

### **Sharing Data**

Lenders should seek to share all currently permissible data, both positive and negative, with other lenders. This should include outstanding credit balances, credit limits, open credit lines, history of repayments and amounts borrowed.

Credit reference agencies and lenders should jointly consider whether there are any changes to data sharing that could assist in more effective identification of over-commitment, especially on credit card limits, usage and repayment behaviour

SCOR should publish plans to continue to develop data sharing, and consult with consumer groups and the Information Commissioner by the end of March 2002

All non-credit organisations taking regular payments from consumers are encouraged to register those payment commitments and defaults with CRAs, if and when they have the necessary consent from consumers.

### **Student loans**

DTI Ministers should press DfEE Ministers to make information about student loans available through credit reference agencies once students have completed their courses.

### **Notification procedures and transparency on interest free option periods, low start agreements and credit cards**

All lenders offering interest free options periods and low start interest agreements should:

- ❖ provide clear and explicit information on the credit agreement form about the type of credit being offered and the payment arrangements
- ❖ clearly notify to consumers towards the end of the interest free option or low interest period and provide a short grace period for late payment of the outstanding balance
- ❖ the Trade Associations should monitor the effectiveness of this approach and review it in a year's time.

### **Unchecked instant credit**

All lenders should adopt the undertaking by the FLA to ban unchecked instant credit.

### **Reasons for credit refusal**

All lenders, whether they use credit scoring or not, should be as clear and specific as possible in communicating reasons for refusal of credit.

Lenders should ensure compliance with the Guide to Credit Scoring.

### **Other issues**

#### **Secured lending 'explanatory' form**

A DTI working group should consider how best to ensure that consumers fully understand the implications of transferring unsecured borrowing to a secured loan and make recommendations by October 2001.

#### **Money advice**

The DTI in partnership with the Money Advice Trust, providers of free money advice and all credit grantors should continue to develop a national infrastructure that results in the ready availability of free debt advice throughout the UK

**TASK FORCE ON TACKLING OVERINDEBTEDNESS**

**TERMS OF REFERENCE**

1. The Task Force will consider the scope for minimising consumer overindebtedness, in particular by:
  - Improving the transparency of information provided to consumers before and when concluding a credit agreement, including the small print;
  - The adoption of core principles of lending practice, including examining an applicant's overall borrowing capacity and ability to repay; and
  - Providing clear notification to consumers on interest free agreements before the final payment is made or an interest bearing repayment programme commences.

The Task Force will consider current evidence on the incidence of overindebtedness and identify how to achieve a better understanding of its extent, cause and effect. It will also identify practical solutions for achieving greater transparency by lenders where a consumer has been declined credit, and improved sharing of data between lenders to aid borrowing decisions.

2. The Task Force will report to the Minister for Consumer Affairs in April 2001.

**MEMBERS OF THE TASK FORCE**

Fiona Price, DTI (Chair)

Tim Sweeney and Mike Young, British Bankers' Association

David Rees, Consumer Credit Association

Michael Coogan, Council of Mortgage Lenders

John Saunders and Jill Stevens, Experian

Martin Hall, Finance & Leasing Association

Christine Farnish, Sarah Wilson and Deborah Arnott, Financial Services Authority

Teresa Perchard, National Association of Citizens Advice Bureaux

Caroline Banks and Martin Goulden, Office of Fair Trading

Elaine Kempson, Personal Finance Research Centre

(NOTE: representation at the Task Force meetings varied for some organisations)

**Organisations represented on the Overindebtedness Discussion Group**

ADVICE AGENCIES, CONSUMER GROUPS AND INDUSTRY ASSOCIATIONS

Association for Payment Clearing Services  
British Cheque Cashers Association  
British Retail Consortium  
Consumer Credit Trade Association  
Consumers Association  
Credit Card Retail Group  
Credit Services Organisation  
Equifax  
Federation of Independent Advice Centres  
Finance Industry Standards Association  
Mail Order Traders Association  
Money Advice Association  
Money Advice Scotland  
Money Advice Trust  
National Consumer Council  
National Pawnbrokers Association  
Sheriffs of England and Wales

GOVERNMENT DEPARTMENTS

Cabinet Office  
Department for Education and Employment  
Department for the Environment, Transport and the Regions  
Department of Trade and Industry  
HM Treasury  
Insolvency Service  
Lord Chancellor's Department  
Office of the Data Protection Commissioner  
Scottish Executive

**DRAFT PROPOSAL FOR AN INVITATION TO TENDER ON RESEARCH INTO THE CAUSE, EFFECT AND EXTENT OF OVERINDEBTEDNESS**

This letter invites you to tender for a study being conducted by the Department of Trade and Industry. The purpose of the study is to provide information on the cause, effect and extent of overindebtedness amongst UK consumers.

**Introduction:**

In October last year a conference was hosted by Dr Kim Howells, Minister for Consumer Affairs, to explore the causes and effects of overindebtedness and look at ways of achieving more responsible lending and borrowing.

The Conference was attended by representatives from the credit industry, the retail sector, the advice sector, and other parties with an interest in consumer debt, including Government Departments. Following the conference Dr Howells set up a Task Force to take forward a partnership of the public and private sectors and identify a number of practical measures for tackling overindebtedness. The Task Force was asked to look at three specific and key areas:

- ❖ Improving the transparency of information provided to consumers before and when concluding a credit agreement, including the small print;
- ❖ Adoption of core principles of lending practice, including examining an applicant's overall borrowing exposure and ability to repay; and
- ❖ Requiring clear notification to consumers on free and low interest agreements before the final payment is made, or moving onto a repayment plan.

The Task Force identified that there had been relatively little research into overindebtedness. It concluded that whilst it could press ahead and address a number of ways of ensuring consumers are better informed and protected when taking out credit, and that this could contribute towards reducing overindebtedness, detailed research should be commissioned.

The intent of this study is to build up a better understanding of the factors, both personal and external, that lead to consumers becoming overindebted. It will also examine the nature and extent of both secured and unsecured borrowing and the incidence of repayment difficulties, plus other debts that act as a contributory cause of overindebtedness.



**Availability of information:**

If you need any further information before submitting the bid, please contact me.

Members of the Task Force will make available to you any data they have that might assist in the study.

**Copyright:**

Copyright of the final report will rest with the DTI. It is expected that the report will be published and full acknowledgement will be given to the authors.

**Payment arrangements:**

*[standard DTI terms and conditions]*

The tender should include a breakdown of the bid price into: your own staff costs; the costs for any works sub-contracted; travel and subsistence.

**The criteria we will use:**

In evaluating the tenders we will particularly look at:

- ❖ the proposed methodology, project plan and timetable
- ❖ understanding of consumer credit and debt issues
- ❖ experience of collecting and interpreting consumer data
- ❖ any track record of studies in this area
- ❖ price

**ARE YOU LOOKING FOR A LOAN?**

**Questions to ask yourself before talking to a lender**

Do I really need a loan?

How much can I borrow?

How do I choose the right loan for me?

How will I repay this loan if my income goes down?

Should I buy Payment Protection Insurance?

Should I use a credit broker?

**Questions to ask a lender before signing an agreement**

How much will this credit cost me?

What will the monthly repayments be?

9. What is the APR for this loan?

Can the monthly repayments increase?

How much will I have to pay if I want to end the loan early?

What happens if I can't manage to keep up my repayments?

What happens if I change my mind after signing?

What's the difference between a secured and an unsecured loan?

Do I get extra rights when I buy on credit?

What can I do if I'm turned down for a loan?

**MAJOR BRITISH BANKING GROUPS – UNSECURED LENDING BY TYPE****(£ million)**

	Personal loans	Credit cards	Overdrafts	Total
1995	21,945	10,263	4,346	36,554
1996	24,563	12,193	4,325	41,081
1997	29,048	13,515	4,688	47,251
1998	31,414	16,091	5,099	52,604
1999	36,098	18,068	5,374	59,540
2000	40,885	20,845	5,765	67,495

Source: British Bankers' Association

**DEBT ENQUIRIES: FIGURES FROM NACAB**

CATEGORY	1996/7	1997/8	1998/9	1999/00	% CHANGE 98/99 – 99/00
Consumer Debt	405,826	433,385	510,938	592,423	16
Housing Debt	132,544	131,287	136,905	132,622	(3)
Utilities Debt	90,696	89,857	95,619	97,241	2
Tax Debt	75,664	68,007	66,454	66,889	1
Benefits Debt	24,671	27,430	31,855	33,768	6
Legal Debt	26,518	24,119	23,339	23,267	-
Employment Debt	15,869	15,922	15,869	17,216	8
Relationships Debt	18,136	16,091	15,372	13,990	(9)
TOTAL	789,924	806,098	896,351	977,416	9

## CREDIT ACCOUNT ARREARS

	Nov. '96	Nov. '97	Nov. '98	Nov. '99	Nov. '00
% of credit accounts with no current arrears	94.15	93.94	94.20	94.23	94.99
% of credit accounts with 1-3 months arrears	4.78	4.75	4.51	4.48	3.89
% of credit accounts with 4-6 months arrears	1.07	1.31	1.29	1.29	1.12
Average credit account default value	£620	£655	£632	£751	£935

**NB:** Credit account information based on data shared by lenders through Experian's credit reference agency

## REGISTRY OF COUNTY COURT JUDGEMENTS

1995	1996	1997	1998	1999	2000	% change 99/00
1,390,140	1,245,830	1,185,367	1,123,568	1,077,499	1,013,044	- 6.0%

Source: Registry Trust Ltd