

SUMMARY OF RESPONSES TO A CONSULTATION OF 2nd SEPTEMBER 2004 ON VOLUNTARY TERMINATION OF HIRE PURCHASE AND CONDITIONAL SALE AGREEMENTS UNDER THE CONSUMER CREDIT ACT 1974

Ministerial Foreword

In September 2004, the Department of Trade and Industry published a consultation paper on the voluntary termination provisions that apply to hire purchase and conditional sale agreements under the Consumer Credit Act 1974.

This consultation grew out of an earlier review of the Consumer Credit Act that was launched in July 2001, and which culminated in the publication of the White Paper “Clear, Fair and Competitive – The Consumer Credit Market in the 21st Century” in December 2003.

The voluntary termination provisions in Sections 99 and 100 of the CCA permit a customer who has repaid at least 50 percent of the total amount due under a hire purchase or conditional sale agreement to hand back the goods to the finance company without further liability. In responses to the White Paper, concerns had been raised by the motor finance industry about losses that were accruing as a result of consumers exercising this right. The industry sought the abolition of the right to voluntarily terminate.

In the light of these concerns, I agreed to consider further the need for changes to the rules governing voluntary termination. Accordingly, a consultation document “A Consultation on Voluntary Termination of Hire Purchase and Conditional Sale Agreements Under the Consumer Credit Act 1974” was published on 2nd September 2004 seeking detailed information and figures relating to voluntary termination and views on options for change. The consultation set out three options – abolishing the rights to voluntarily terminate; altering the threshold, so that the right to voluntarily terminate would only apply once a higher percentage of the credit had been paid-off; or retaining the provisions unchanged.

The Consultation period closed on 30th November 2004. We received a total of 40 responses, and we are very grateful to everyone who took the time to let us have their views.

On balance, the Government has decided that changes to the voluntary termination provisions are inappropriate at present. The reasons for this decision are as follows.

Firstly, the responses to the consultation do not add up collectively to a mandate for change. There was an absence of consensus on the best way forward. Broadly speaking, enforcement bodies and groups representing consumers argued for the retention of the existing provisions. The credit industry lobbied equally forcefully for their removal. There was little or no enthusiasm for the compromise proposal of moving the voluntary termination threshold.

Secondly, it has become clear that it would not be possible to remove the provisions on voluntary termination in isolation. Given their position at the heart of the law on

hire purchase, to do so could call the whole concept of HP into question. We do not therefore believe that they should be abolished without a wider consultation on the future of hire purchase and other forms of secured lending for goods and vehicles. Unfortunately, the issue was raised too late in the day for this to take place in the context of the Consumer Credit Bill that was introduced into Parliament in December 2004.

While the responses from the credit industry emphasised the impact of the voluntary termination provisions on motor vehicle finance, it is also important to remember that hire purchase does not just apply to the motor finance sector. It is also extensively used to finance the purchase of “white goods”, and the consultation revealed no pressure from that sector for the abolition of the voluntary termination provisions.

This document summarises the responses that were received to the questions posed in the consultation.

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Breakdown of Responses

In total, 40 substantive responses were received to the consultation document, the breakdown of which was as follows:

- Industry 26
- Consumer Organisations and Individuals 7
- Regulatory Bodies and Lawyers 7

Questions 1 – 7 focused on the impact of the voluntary termination provisions on the credit sector. As such, they were primarily aimed at lenders.

Question 1: How much of your total business – in both percentage terms and monetary value is accounted for by:

- a) Hire purchase and conditional sale finance for vehicles***
- b) Hire purchase and conditional sale finance for other goods?***

Please give separate figures for HP and CS, if possible.

Collective data supplied on behalf of lenders responsible for around 50 percent of new car finance stated that they had £17.6 billion outstanding on hire purchase or conditional sale agreements. This accounted for around 94 percent of the total value of motor finance provided by these lenders in 2003.

At the end of 2003, these lenders had around £10 billion outstanding on hire purchase or conditional sale agreements for purposes other than vehicle finance.

Question 2: How much of your total business – in both percentage terms and monetary value is accounted for by:

- a) Hire purchase and conditional sale finance to private individuals***
- b) Hire purchase and conditional sale finance to unincorporated bodies for business purposes?***

Please give separate figures for HP and CS, if possible.

Collective data supplied on behalf of lenders responsible for around 50 percent of new car finance stated that they had £18.9 billion outstanding on hire purchase or conditional sale agreements to private individuals. £4.9 billion was outstanding on hire purchase or conditional sale agreements for business purposes.

Question 3: How, if at all, do you expect the distribution of your business to change in future?

Those industry respondents who responded to this question indicated that, as a consequence of borrowers exercising their right to voluntarily terminate agreements, they would be reviewing their lending policies. Some of those respondents indicated that they would either offer fewer hire purchase or conditional sale agreements in

future, or would be more discerning in deciding with whom they would do business. One respondent had already ceased to offer hire purchase agreements for periods longer than 48 months.

One industry respondent, from outside the motor finance sector, indicated that in their experience voluntary termination was still uncommon, and that it was therefore unlikely that lenders would feel the need to change their lending practices.

Question 4: How much of your business is currently written in respect of HP agreements and Conditional Sale agreements that carry VT rights (i.e. for amounts of less than £25,001)?

Collective data supplied on behalf of lenders responsible for around 50 percent of new car finance stated that around £15.2 billion is currently written in respect of hire purchase or conditional sale agreements that carry voluntary termination rights.

Question 5: How much is currently written (HP and CS Agreements) for individuals in a personal capacity above £25,000?

The industry respondents who responded to this question indicated that the overwhelming majority of current hire purchase and conditional sale agreements were for amounts falling below the £25,000 threshold. Agreements for amounts above £25,000 were a small minority of the total.

Question 6: What proportion of VTs result in another vehicle or other goods being supplied subject to another HP or CS agreement?

There was a wide range of experience from the industry respondents who responded to this question. One said that most voluntary terminations resulted in a new agreement; another said that 38 percent of agreements were rolled-over – 22 percent with the same lender.

Some lenders in the motor finance sector chose to interpret this question more widely – stating that the voluntary termination provisions were abused by consumers who had exceeded the mileage permitted in their agreements; that only a very small proportion of those exercising the right were in genuine financial difficulty; and that some car dealers were encouraging consumers to voluntarily terminate at the expense of lenders.

Question 7: How much of your business is accounted for by other financial products offered along with HP and CS agreements e.g. insurance?

The limited responses received from industry respondents to this question indicated that associated financial products are of marginal significance in the motor finance sector.

The sole consumer group who responded to this question highlighted the propensity for insurance to be sold to the most vulnerable, and the consequent need for such products to be sold separately.

Question 8: How, if at all, do you think lenders will change their business practices if the law remains unchanged? What benefits or disadvantages would this have for consumers?

The industry respondents who responded to this question were unanimous in their expectation that a continuation of the existing provisions on voluntary termination would have the effect of reducing the overall hire purchase market. These responses suggested possible market distortions – that lenders would switch lending from hire purchase to personal loans; would tighten their credit-scoring mechanisms and only offer hire purchase to those with good credit ratings; and would pursue more rigorous policies in respect of default. Generally, lenders foresaw fewer hire purchase deals – with a reduction in choice for consumers; more expensive finance; and some borrowers, particularly those on lower incomes, being refused credit. They anticipated that deposits would increase and that the length of hire purchase agreements would shorten.

One respondent suggested that it might decide to pull out of the vehicle-financing sector. However, another suggested that cases of voluntary termination were rare and that there was therefore no reason to change the law.

The consumer groups who responded to this question were sceptical about claims by lenders that they would move away from hire purchase lending. One stated that lenders had it in their power to design their products in a way that minimised or avoided losses – for example, by increasing the amount of the initial deposit to match the point at which the 50 percent threshold is reached with the anticipated depreciation rate of the vehicle. Another questioned whether lenders would really be content to give up the security over the goods financed that hire purchase provides. A further consumer respondent expressed concern about the prospect of lenders moving their business towards unsecured loans.

The regulatory bodies who responded to this question also took the view that there was insufficient evidence to justify a change in the law. One pointed out that lenders would withdraw from the hire purchase market if they found it uneconomic, but that there was no evidence that they were doing so. Another stated that some lenders might have to ask for larger deposits or introduce option to purchase fees. It was pointed out that providers of hire purchase that did not involve motor vehicles did not support the abolition of the voluntary termination rights.

Question 9: Why should consumers have greater rights in relation to HP and CS agreements than in relation to other forms of consumer credit?

The industry respondents who responded to this question were unanimous in their view that there was no justification for borrowers under a hire purchase or conditional sale agreement to have any greater rights than those that apply under consumer credit agreements generally. Some respondents suggested that the new measures resulting from the Government's Consumer Credit Review had already shifted the balance in favour of the borrower and had made the voluntary termination rights unnecessary.

The consumer groups who responded to this question took the opposite view. They argued that additional protections were justified because the borrower in a hire

purchase agreement has no title to the goods financed by the agreement and is therefore in danger of repossession. One respondent highlighted the absence of rights of withdrawal from hire purchase agreements as a justification for the continuance of the right to voluntarily terminate.

The regulatory bodies who responded to this question also took the view that the absence of title justified the granting of additional rights to the borrower. One respondent suggested that lenders' losses might be connected to product design – for example, small deposits and finance over long periods.

One respondent from the legal profession saw no good reason for the retention of the provisions on voluntary termination, describing them as “rough and ready”.

Question 10: Please provide case histories of how VT provisions have provided necessary consumer protection.

One industry respondent reported that 21 percent of those exercising the right to voluntarily terminate did so because they could no longer afford the finance. In contrast, 17 percent were dissatisfied with the vehicle, 14 percent wanted a new car and 10 percent had found cheaper finance elsewhere.

Other industry respondents reported that those who were voluntarily terminating were rarely in financial hardship – it was suggested that over 80 percent are not in arrears, while fewer than 10 percent are in arrears of more than three months.

The consumer groups who responded to this question maintained that some borrowers were exercising their voluntary termination rights because of hardship. One noted that voluntary termination was not necessarily in the interests of the consumer – it knew of borrowers who tried to make their payments because they would otherwise lose the vehicle financed under the agreement.

One of the regulatory bodies who responded to this question suggested that the threat to voluntarily terminate was sometimes the only way to ensure that dealers rectified faults to vehicles.

Question 11: What scope do you see for amending the current provisions so that lenders do not suffer losses at the current rate but consumers retain the right to escape an agreement where the underlying asset may be worth less than the liability?

The industry respondents who responded to this question saw no scope for a satisfactory amendment to the provisions. Their view was that the voluntary termination provisions were being used by consumers to escape their liabilities under the agreement. Consequently, the view was expressed that there should only be a right to voluntarily terminate once those liabilities had been settled.

The sole consumer group who responded also saw no scope for change. However, it thought that the 50 percent provision was the correct one, and pointed out that it was within the power of lenders to adjust the structure of their products.

The regulatory bodies who responded to this question also supported the status quo. They felt that a figure of 50 percent gave lenders the scope to design products in a way that avoided losses.

One respondent from the legal profession said that there was no legal principle that justified the right to voluntarily terminate.

Question 12: VT rights are currently based on 50% of the amount owing. Is there any justification for amending the percentage and, if so, to what figure so as to achieve a different balance between retaining the right of the consumer to hand back the goods hired and to reduce the losses suffered by providers of this type of finance?

Industry respondents took differing views on this point. A minority of those who responded said that any percentage would be artificial, and that they would only support outright abolition. A majority of those who responded said that – while their preference was clearly for abolition – a higher threshold would help to reduce losses. Several respondents suggested a figure of around 75 percent. One respondent suggested that further research would be needed into the effects of a change in the percentage. A further respondent suggested a compromise that would require the hirer to make up the difference between the market value of the goods returned and the settlement figure that would apply under the new rules on early settlement that come into force on 31st May 2005.

The sole consumer group who responded saw no justification for any change in the percentage that would have the effect of reducing the rights of consumers.

The regulatory bodies who responded to this question opposed change for the same reasons. One stated that a higher percentage would remove the imperative on lenders to fix the cost of the hire purchase to the value of the asset.

Question 13: Is there any merit in having a sliding scale for the outstanding percentage liability which would depend on the original value of the goods? If so, what figures would be appropriate? Would this proposal add unnecessary complexity?

The industry respondents who responded to this question opposed the introduction of a sliding scale. One stated that it would prove too complicated to operate.

The consumer groups who responded to this question saw some merit in a sliding scale, but on balance preferred no change to the current arrangements. It was suggested that a sliding scale should start at around 33 percent for white goods and consumer durables.

The sole regulatory body who responded to this question favoured the retention of the 50 percent rule.

One respondent from the legal profession said that a sliding scale would be less fair than an approach that focused on the market value of the goods.

Question 14: Is there any other way to provide protection for the consumer whilst at the same time ensuring that a reasonable lender does not suffer a financial loss?

A substantial majority of the industry respondents who responded to this question felt that further protections were unnecessary. They commented that consumers were already adequately protected and noted that existing protections would soon be augmented by the new rules on the early settlement of loans that come into force on 31st May 2005; and by the provisions in the Consumer Credit Bill dealing with unfair credit transactions. One respondent stated that the right to voluntarily terminate is of no practical use to consumers who are in financial difficulties; another thought that competition offered alternatives. For example, agreements that incorporate a “balloon payment” – an optional fee paid by the borrower at the end of the term of the agreement should he or she wish to take possession of the vehicle – offered consumers both flexibility and protection.

One industry respondent suggested amendments to either section 129 or section 133 of the Consumer Credit Act to allow the courts to make an order permitting voluntary termination if they are satisfied that the consumer is in financial difficulties.

The consumer groups who responded to this question suggested various alternative ways in which to protect consumers – strengthening the Time Order rules to make it easier for consumers to renegotiate with the lender while keeping the vehicle; permitting the alternative dispute resolution mechanism provided for under the Consumer Credit Bill to intervene to decide on the discount value of the goods; strengthening guidance; requiring lenders to renegotiate; and giving the courts the power to rule that an agreement has been satisfied when considering a Repossession Order.

The regulatory bodies who responded to this question saw no need for any changes – arguing that lenders had it in their power to restructure their products in a way that would discourage exploitation of the voluntary termination provisions by financially sophisticated hirers.

Question 15: Are there particular issues with PPI or other insurance products that may not terminate automatically on VT, or may not allow for a refund of premiums? Do you have any suggestions for remedying the position?

Industry respondents who responded to this question stated that a combination of new rules on the form and content of credit and hire agreements that will come into force on 31st May 2005; adherence to industry codes of practice; and Financial Services Authority rules on the selling of insurance products would ensure that Payment Protection Insurance was sold and administered in a fair and transparent way.

The consumer groups who responded to this question argued that industry codes should be brought into line with FSA guidelines to require the cancellation of PPI on voluntary termination.

The regulatory bodies who responded to this question also believed that PPI should be dealt with on termination in accordance with FSA rules.

One respondent from the legal profession advocated a legal provision requiring a proportional refund of PPI premiums on termination.

Question 16: What evidence is there that consumers are suffering detriment as a result of the manner in which VTs are managed by lenders? Please provide specific examples.

Industry respondents admitted that there had been some complaints, but did not provide any specific examples.

Consumer groups reported a steady stream of complaints from consumers about the way in which voluntary terminations are administered – not least lenders requiring vehicles to be returned over long distances.

Regulatory bodies also felt that the balance was tipped in favour of lenders, and reported examples of vehicles having to be delivered to locations hundreds of miles away; as well as the imposition of charges by lenders.

Question 17: Please give recent examples of situations (including those not involving vehicles) where lenders have made losses through having to comply with the VT provisions.

One industry respondent stated that borrowers also abuse the voluntary termination provisions – by returning vehicles that are in poor condition; by abandoning the vehicle; or by delaying the return of documents.

Question 18: How much do you consider your business currently loses as a result of consumers making use of the VT provisions? Please give actual examples of cases where a loss was suffered. Please also state the loss as a percentage of total losses experienced with HP and CS transactions for VT and bad debts etc.

Industry respondents reported various average losses, in the range of £1,500 to £3,000 on each transaction. One respondent said that these losses accounted for around 44 percent of all credit losses.

Collective data supplied on behalf of lenders responsible for around 50 percent of new car finance assessed total losses at £83 million in 2003.

Question 19: How will the level of losses change if the limit on CCA agreements is removed bearing in mind that the limit for lending to partnerships of three or fewer and sole traders will remain at £25,000?

Industry respondents anticipated some increase in losses as a consequence of voluntary terminations once the financial limit in the Consumer Credit Act is removed. Two lenders stated that they would be unlikely to offer hire purchase agreements above £25,000, and that this might mean a switch across the industry to higher value unsecured loans.

Collective data supplied on behalf of lenders responsible for around 50 percent of new car finance estimated that total losses would rise to around £91.3 million per year.

Question 20: How will the new Early Settlement Regulations affect the figures quoted in answer to the questions above? In other words if the new calculation for the amount outstanding in the event of early settlement is taken into account how does this affect the loss indicated in your previous answers?

Industry respondents generally acknowledged that the introduction of new rules governing the early settlement of loans from 31st May 2005 would limit the scale of losses on voluntary termination that are currently assessed in the context of the Rule of 78. One respondent thought that the new rules on early settlement might themselves reduce the attractiveness of voluntary termination in some cases and therefore lead to a reduction in the overall number of voluntary terminations.

Collective data supplied on behalf of lenders responsible for around 50 percent of new car finance estimated that the new rules on the early settlement of loans would have the effect of reducing the 2003 total losses to around £67.4 million.

Question 21: What measures do owners take to mitigate the effect of Section 99 and 100 when entering into HP and CS Agreements? For example, do the size of deposits reflect the depreciating value of the underlying asset. Do some lenders refuse HP transactions on certain types or value of goods and why?

One industry respondent stated that it attempted to mitigate its losses by not offering hire purchase agreements for periods of more than 48 months. Other respondents said that mitigation was difficult in practice because competitive pressures from other lenders had the effect of keeping deposits low; that the effect of the current level of voluntary terminations was to force up the price of agreements for all consumers, harming competition; and that the provisions made lenders reluctant to grant hire purchase to small businesses for IT and office equipment.

Question 22: Apart from suffering financial loss what are the other reasons for considering that the current provisions should be removed or amended?

The industry respondents who responded to this question cited various reasons why the provisions on voluntary termination should be abolished – that the provisions were not generally being used for the purpose for which they were designed; that abolition would mean that the same rules would apply to all forms of borrowing; that the overall effect of losses from voluntary terminations was to put up the average cost of every hire purchase agreement by around £50; and that lenders had responded to losses by limiting access to hire purchase, which was harming the most vulnerable borrowers who have traditionally relied on it the most.

One respondent said that lenders had switched from hire purchase to taking bills of sale, which was inconvenient.

The consumer groups who responded to this question saw no justification for removing or amending the provisions on voluntary terminations.

One respondent from the legal profession advocated reform that would mean more consistent rights for borrowers in all forms of lending.

Question 23: If VT is removed what is the likely impact on consumers and in particular those consumers who could be described as “vulnerable”?

Opinion amongst industry respondents who responded to this question was evenly divided. Half of the respondents thought that the removal of the voluntary termination provisions would have no impact on vulnerable consumers – one respondent noted that, in its experience, around 75 percent of voluntary terminations were by borrowers who were less than four weeks late in their repayments.

The remaining industry respondents felt that abolition would have a positive impact on vulnerable consumers – it would mean that hire purchase would remain available; and would make the market more competitive, with the result that some consumers would find it easier to get access to the prime lending sector.

The consumer groups who responded to this question were unanimous in foreseeing only consumer detriment were the voluntary termination provisions to be removed. They said the removal of a key protection would mean that consumers who were in genuine difficulties would suffer.

The regulatory bodies who responded to this question also stated that abolition of the provisions on voluntary termination would harm vulnerable consumers. One said that the vehicles purchased by such consumers under hire purchase agreements were often over priced with high interest rates.

One respondent from the legal profession argued that, while all consumers should have the right to settle early, they should do so in the same way across all credit products.

Consumer and Competition Policy Directorate
Department of Trade and Industry
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SMALL FIRMS IMPACT TEST

While a number of the 40 substantive responses received to this consultation were from small finance companies, most of these were subsidiaries of larger lenders. A further response was received from a trade association representing smaller lenders.

Officials engaged and actively sought views from organisations representing the small business community as a whole, but without success.

Impact on Small Businesses in the Consumer Credit Sector:

It was difficult on the basis of the responses received to discern any specific small business view on the future of the voluntary termination provisions. However, the position within the finance sector as a whole was very strongly in support of repeal of the voluntary termination provisions, and it is therefore reasonable to conclude that small businesses in the hire purchase market will hold the same opinion. That being said, we discerned a more pragmatic view on the part of the trade association that represents smaller lenders which suggested that its members are managing their losses as a result of voluntary termination of hire purchase agreements, and that those losses are declining.

It should also be noted that responses from lenders were very heavily biased in favour of those who offer hire purchase for motor vehicle finance. In contrast, no responses were received to the consultation from lenders, of any size, who offered hire purchase for the financing of consumer durables or “white goods”. Officials actively sought the views of firms in this sector, and two respondents indicated there was no pressure for the removal of the voluntary termination provisions within that specific market.

Impact on Small Businesses Using Hire Purchase or Conditional Sale Agreements to Finance the Purchase of Goods:

The Consumer Credit Act 1974 provides that borrowing by what can be described as small businesses – sole traders, partnerships and unincorporated associations – for amounts up to and including £25,000 will be regulated under the provisions of the Act. Hire purchase agreements taken out by such borrowers therefore include the right to voluntarily terminate the agreement – giving small business borrowers the same rights as those enjoyed by consumers to extricate themselves from agreements that may have turned out to be disadvantageous, and which at the sub-prime end of the market can be expensive.

Provisions in the Consumer Credit Bill that was introduced into Parliament in December 2004 will restrict regulation to partnerships of three or fewer partners; and will provide that lending for more than £25,000 to small businesses will only be regulated if it is not wholly or predominantly for business purposes.

No responses to the consultation were received from small businesses in their capacity as consumers of hire purchase finance.

However, responses by the credit industry put forward the view that abolition of the voluntary termination provisions would make hire purchase cheaper and easier to

obtain. This, in turn, would benefit small firms – and particularly new start-ups – which would find it easier to finance, for example, a vehicle for their business. It was also stated that, if hire purchase was more easily available, businesses could make use of first year tax allowances which are not available when a vehicle is leased.

Size of Market in 2003:

The following figures were provided by industry respondents to the consultation. They suggest that, while the market for providing hire purchase finance to small businesses is a significant one, the market for consumer finance remains far more substantial.

Total amount outstanding at end of 2003 on regulated hire purchase agreements (including small businesses)	£15.2 billion
Total amount lent to businesses on regulated hire purchase agreements	£4.9 billion
Number of Voluntary Terminations in 2003	52,000

Conclusion:

It proved difficult to discern any distinctive small business voice in the responses received to the consultation. Officials sought to remedy this by making approaches to specific small business organisations after the consultation had closed, but with limited success.

The consultation suggested that small lenders were experiencing the same sort of problems as larger lenders with the provisions that allow the voluntary termination by consumers of hire purchase and conditional sale agreements.

However, the consultation provided no clear evidence that either consumers or small businesses (acting as consumers) are suffering as a result of the current provisions on voluntary termination of hire purchase agreements. Indeed, it suggested that many consumers and small businesses take advantage of the provisions, not only to avoid liability because of financial difficulty, but also because they provide the opportunity to take out a new agreement for another vehicle. Figures supplied by industry respondents indicated that at least half of voluntary terminations result in a new agreement to purchase another vehicle.

End

DTI
Consumer and Competition Policy Directorate

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