

# **REVIEW OF THE CONSUMER CREDIT ACT: PROGRESS REPORT**

**August 2002**

## MINISTERIAL FOREWORD

Last July I announced the first major review of our consumer credit laws for almost 30 years. My aim is to create a modern regulatory framework that protects consumers against loan sharks and unfair lending practices, while enabling business to operate competitively in a modern credit market.

As a first step I published a consultation paper *Tackling loan sharks – and more!* that set out our plans and identified the priority areas we proposed to tackle. This report sets out the progress that has been made on both the review of the Consumer Credit Act and the work on overindebtedness, and the direction of the next phase of our work.

Our aim has been to conduct this review in close partnership with all affected: credit companies, consumer groups and regulators. We have engaged in extensive consultation to develop the policy on each issue to be covered in the review. I realise this has placed a heavy work burden on the industry representatives and consumer groups that have been involved in these discussions with my officials. I am very grateful for all the work that has been put in. We are moving forward on a wide front of change and I know this preparatory work is already showing positive results. Our next steps include developing a range of options that will tackle extortionate credit agreements head-on, including facilitating consumer redress, and reforming the process involved in licensing decisions and appeals. Together we are developing a responsible and competitive credit market fit for today's consumers.

To sum up, our consultations show that there is a real appetite for change; we have made a start in mapping the way forward; but there is still much to do.

Melanie Johnson MP  
Parliamentary Under Secretary of State  
for Competition, Consumers and Markets  
Department of Trade and Industry

## CREDIT AND DEBT – THE LAST YEAR

The last year since the announcement of the review of the Consumer Credit Act and the report of the Task Force on overindebtedness has seen a great deal of activity in relation to credit and debt.

This has been undertaken against an economic backdrop of increased consumer borrowing. The Task Force report noted that borrowings (excluding mortgages) had increased by 46% between 1997 and 2000, and 2001 saw a further 10% increase to £140.3 bn. This almost certainly reflects the buoyant economy, low interest rates and high levels of 'feel-good' factor among consumers. Similarly, statistics from the National Association of Citizens Advice Bureaux (NACAB) show that the number of enquiries received by CABx relating to consumer debt continues to grow, up by 18% between 1998/99 and 2000/01 to 604,006.

The main activities have been:

- ❖ the new 'Stop Now' powers enabling OFT to enforce consumer credit legislation more effectively. OFT has used its powers in 59 cases involving consumer credit.
- ❖ the launch in March of a new pilot telephone debt advice service to help consumers who get into difficulties. The service has already handled over 11000 calls and e-mails.
- ❖ consulting on and responding to the European Commission's proposals for amending the Consumer Credit Directive.
- ❖ Securing agreement from stakeholders to the priority areas for the Consumer Credit Act review:
  - ❖ the financial limit and exempt agreements under the Act
  - ❖ the early settlement regulations
  - ❖ enabling consumers to conclude credit agreements on-line
  - ❖ changing the licensing regime to target enforcement on keeping the loan sharks out of the market
  - ❖ making the extortionate credit provisions more effective

- ❖ simplifying the advertising regulations, including the regulations on APRs, and
  - ❖ simplifying the rules on multiple agreements
- ❖ undertaking research into the cause, effect and extent of overindebtedness, with the findings to be published in the Autumn.

In the next year we will:

- ❖ follow up a report by the Cabinet Office's Performance and Innovation Unit (PIU), by looking more widely at the support given to strategies for preventing overindebtedness, and
- ❖ as part of the review continue to develop options for actions targeted on rogue traders. Options being considered include:
  - reforming the current process for credit licensing decisions and appeals
  - strengthening the provisions in the Act against extortionate credit
  - an alternative to the courts for re-opening extortionate credit agreements, and
  - an independent redress mechanism for consumers

The Office of Fair Trading, following investigative action by itself or local trading standards offices, is responsible for undertaking any licensing action. However, its role as both the investigator and adjudicator on any action requires a clear internal separation of these activities to avoid any compromising of their independence. This is not the best solution, so consideration is being given to separating the activities for determining decisions on licensing action, and reforming the process for dealing with any subsequent appeals.

We propose to consult on options for changes to the extortionate credit provisions of the Act in the Autumn. One option is to re-define what is an extortionate credit agreement, while another is to explore the introduction of a 'fair and reasonable' test against which credit agreements could be measured.

Finally, we are considering the possibility of an independent redress mechanism for consumers. This could operate on a 'tribunal' type basis and deal with individual complaints, and might even be extended to providing an alternative to the courts for consumers seeking to get an extortionate credit agreement re-opened.

## **CONSUMER CREDIT ACT REVIEW**

Last July we published a consultation document *Tackling loan sharks – and more!* that set out proposals to review the Consumer Credit Act. The five main drivers for undertaking a review were:

- ❖ to implement the Government's manifesto commitment to tackle loan sharks
- ❖ the need for improvements in the current consumer credit licensing regime
- ❖ the Financial Services Authority taking on the regulation of mortgages
- ❖ the European Commission consulting on a revised Consumer Credit Directive, and
- ❖ the possible need for changes to implement the outcomes from the Task Force on tackling overindebtedness

It also set out what we saw as the priority areas for reform of the Act and in February of this year we published a report summarising the responses to the consultation. This confirmed that the priority areas should be:

- ❖ the financial limit and exempt agreements under the Act
- ❖ the early settlement regulations
- ❖ enabling consumers to conclude credit agreements on-line
- ❖ changing the licensing regime to target enforcement on keeping the loan sharks out of the market
- ❖ making the extortionate credit provisions more effective
- ❖ simplifying the advertising regulations, including the regulations on APRs, and
- ❖ simplifying the rules on multiple agreements

Since the initial consultation on the priorities for the review we have undertaken focus group discussions on each issue with representatives from the lending industry, consumer bodies and regulators. As a result, in March we were able to publish our first priority issue consultation and seek views on options for:

- ❖ increasing / removing the financial limit for credit agreements regulated by the Act
- ❖ re-defining or excluding business lending caught by the Act, and

- ❖ reducing the categories of agreement exempted from the Act.

This consultation closed on 21 June and a total of 55 responses were received. We aim to publish a summary of responses to the consultation by the end of September, but initial indications suggest support for:

- an increase in the financial limit
- a redefining of business lending so that only small businesses continue to receive the protections of the Act, and
- the amendment, rather than removal, of some current exemptions

The second priority issue is the early settlement regulations, where many lenders use a formula called the 'Rule of 78' for determining a settlement figure. The formula favours lenders and for some loans of a high value and long term nature can impose unreasonably high early settlement costs on the consumer. A consultation paper was issued this month on:

- ❖ amending the rules so they are fair and equitable to both lender and consumer, and
- ❖ the provision of illustrative, up-front information on early settlement terms

The consultation closes on 22 November 2002 and we propose to issue a summary of responses by the end of January 2003.

Research has also been commissioned to assist the development of policy in some key areas. In March we undertook research into the US credit market to identify whether there were any emerging creditor practices in the world's most advanced market that are, or may, impact adversely on the consumer. This would enable us to explore if it is possible and appropriate to undertake some future proofing of the Act. In the event the research, which can be accessed via the DTI website's consumer credit page [www.dti.gov.uk/CACP/ca/policy/consumercredit/review.htm](http://www.dti.gov.uk/CACP/ca/policy/consumercredit/review.htm)], showed no new major issues of consumer detriment that might be 'exported' to the UK in the next few years. In addition, we are currently researching the use consumers' make of credit

advertising to inform our work on simplifying the credit advertising regulations. It seeks to identify whether consumers use some or all forms of advertising primarily as a signposting mechanism to possible credit providers, or as an important element in the decision making process.

The next priority issue for consultation is enabling lenders and consumers to conclude a credit agreement on-line. The Consumer Credit Act currently contains provisions that present a barrier to making on-line agreements. Work is currently being undertaken on reviewing these barriers and also examining where clarification of the legislation would be helpful. Focus group discussions will start on this issue shortly, followed by a formal consultation paper. The timing of subsequent consultations is currently as follows:

On-line agreements	Autumn 2002
Licensing regime	Autumn 2002
Extortionate credit	Autumn 2002
Advertising Regulations & APRs	Winter 2002/03
Multiple agreements	Spring 2003

Prior to a consultation paper on each of these issues we will be holding further focus group discussions and seminars to develop the policy with the key stakeholders for the lending industry and consumer groups.

We have set up a page on the DTI website which can be used to access news about the review. This can be found at:

[http://www.dti.gov.uk/ccp/consumer\\_finance.htm](http://www.dti.gov.uk/ccp/consumer_finance.htm)

## **TASK FORCE ON TACKLING OVERINDEBTEDNESS**

The Task Force on Overindebtedness was set up in October 2000 by then Consumer Minister Dr Kim Howells. Its members include representatives from the credit industry, regulators, and consumer organisations who have come together to focus on practical ways of achieving more responsible lending and borrowing. The Task Force published a report in July 2001 and its recommendations suggested further work in several areas, amongst them the setting up of five DTI-led Working Groups to take forward certain issues.

Another recommendation suggested that DTI commissioned research into overindebtedness.

These groups have met on a number of occasions between last Autumn and this Spring, and have just submitted their recommendations to the Task Force.

The first working group looked at key questions consumers should ask before taking out a loan with the aim of ensuring that the potential borrower asks whether he/she really needs a loan, whether they can afford it and what is the best and most appropriate deal.

The second group looked at credit marketing and measures for safeguarding financially vulnerable consumers, including making terms and conditions clearer and encouraging appropriate pre-screening of consumers by lenders before they extend offers or opportunities for taking on further credit.

The third group examined information consumers should receive prior to taking out an agreement to enable them to assess affordability, and compare different deals before signing an agreement. It also looked at how this information could be presented more clearly and understandably in credit agreements.

The fourth group covered payment protection insurance (PPI) and concluded that it can provide valuable protection against changes in a consumer's financial circumstances. However, the Group identified scope for improving transparency for consumers about the terms of PPI and for ensuring that consumers were fully aware when they had signed up for PPI.

The final group looked at how best to ensure consumers understood when a loan was secured on their home and that there was a risk of repossession if they then defaulted on the loan. There was particular concern that some consumers moving from unsecured to secured lending, e.g. when consolidating loans, did not fully understand the consequences. The group considered the inclusion of an additional wealth warning making it clear to borrowers that their home could be at risk of repossession.

In response to a Task Force recommendation, DTI commissioned MORI to carry out research into the cause, effect and extent of

overindebtedness amongst UK consumers. The research will contribute a better understanding of the factors, both personal and external, that lead to consumers becoming overindebted. We have just received some interim results which show that:

- three quarters of households in Britain had credit facilities.
  - 4% of all households owed over £10,000
  - 5% of all households had repayments exceeding over a quarter of their gross income
- only 1 in 5 of heavy credit users (i.e. with repayments over a quarter of gross income) feel over-borrowed
  - but half of them were either in arrears or said they were facing financial difficulties
- nearly a quarter of households had been in arrears with their regular commitments or had faced financial difficulties in the past 12 months
- loss of income is the main reason for consumers becoming overindebted; with low income an important reason for arrears

A full report will be made public later this year.

The Task Force is now considering the outcomes of the research and the working groups and will report its conclusions later this year.

### **STOP NOW ORDERS**

In June 2001 the Stop Now Orders Regulations came into effect. These give enforcement bodies (including the OFT and Trading Standards Officers) new powers to take action to stop acts which breach consumer credit legislation, and which harm the collective interests of consumers, rather than having to take lengthy action to revoke licences. Since June, OFT has taken action under the new regulations in 59 cases related to consumer credit. So far 40 of these traders have agreed to change their practices, without the need for court action.

## **CONSUMER CREDIT DIRECTIVE**

In June 2001 the European Commission published a white paper on its proposals to amend the Consumer Credit Directive to reflect market changes and encourage growth of a single market. The main proposals included redefining the extent to which mortgages are excluded from its scope, more stringent controls on credit intermediaries, improving the information given to consumers and reducing the risk and impact of payment default. We consulted widely with industry, consumer groups and others and held a seminar on the White Paper in June 2001 to inform the Government's response. This response was submitted in October 2001 and broadly welcomed the proposals, including the Commission's move towards a high level maximum harmonisation directive, but opposed the proposal for compulsory payment protection insurance. While it is right that consumers should be encouraged to consider insurance, it will not be appropriate or necessary in every case. We expect the Commission to publish a revised draft Directive shortly and will be consulting widely once a text is available.

## **MORTGAGE REGULATION**

Ruth Kelly, Economic Secretary at HM Treasury, announced in December 2001 that in the light of industry views she had decided that FSA's role should be extended to cover regulation of arranging and advice in connection with first charge mortgages, whether by mortgage intermediaries or lenders. The previous approach restricted FSA regulation to the activities of entering into and administering such mortgages but fell short of regulating advice. FSA would also take on regulation of general insurance intermediaries, consistent with the Insurance Mediation Directive.

As a result, the date on which FSA will take on its new regulatory responsibilities has been put back from summer 2002 to spring 2004. This may have implications for the review of the Consumer Credit Act and particularly for the timing of implementation of changes. FSA is considering what changes may be needed to the approach and rules on which it had consulted to take account of the wider scope of responsibilities. We are keeping in close touch with them.

## **DEBT HELPLINE**

In March 2002 Melanie Johnson formally launched a pilot project to test the effectiveness of telephone advice on debt problems. The project is being managed by the Money Advice Trust and is funded by contributions from Government and from major lenders and is running in three locations – Birmingham, Fife and Cornwall. Since it opened for business, the helpline has handled over 11000 calls and e-mails, and taken over 100,000 hits per month on its website. Already over one hundred consumers are actively receiving help to start a debt repayment programme. The project will run until March 2003. We will begin evaluating the project in late summer 2002 to inform a decision on whether and, if so, in what form the service should continue.

## **PIU REPORT ON GOVERNMENT LOANS**

A report by the Performance and Innovation Unit (PIU) – “Lending Support: Modernising the Government’s Use of Loans” – was published in March 2002. The report looked at the way the Government used loans to both individuals and businesses. Amongst the report’s conclusions was a recommendation that the Government should review the support given to strategies for preventing overindebtedness. DTI will be leading this review, which will report in summer 2003. The review will also link in with the evaluation of the debt helpline.

---

URN 02/1241