

**TASK FORCE
ON TACKLING
OVERINDEBTEDNESS**

SECOND REPORT

EXECUTIVE SUMMARY

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1 This is the second report of the Task Force on Overindebtedness, set up by the then Consumer Minister, Dr Kim Howells, in October 2000. It concentrates on the issues raised by the research carried out for DTI in response to the first report and the areas covered by the Working Groups set up to investigate further some of the issues and possible solutions identified in the first report. Its scope is therefore narrower than that of the first report. In addition to the further recommendations made here, the Task Force continues to attach importance to the recommendations made in the first report and has taken this opportunity to review progress on their implementation.

2 The research found that most households used credit modestly but around 5% were heavy credit users and around 20 % were in financial difficulties at the time of the survey, most with household bills rather than consumer credit. The major cause of financial difficulties was loss of income, particularly job loss, although they were also strongly associated with setting up home and having a family and with relationship breakdown. The research also found some evidence of irresponsible borrowing and irresponsible lending associated with financial difficulties.

3 Compared with the last similar survey in 1989 more households had credit facilities but the proportion actually using those facilities to borrow was about the same. However, the amounts owed by credit users were significantly higher. The historically high levels of borrowing are problematic for only a small number of people but a far greater number would be at risk in an economic downturn or a period of sustained increases in interest rates. While macro-economic conditions are very different now compared with 1989, uncertainties remain and there is no room for complacency. The Task Force therefore sees a need to put in place measures to monitor developments through regular surveys and a more permanent role for the Task Force itself in monitoring and considering any emerging problems.

4 The research considered whether particular factors were correlated with being in financial difficulty. It identified that high risk of getting into financial difficulties was associated with

- having four or more current credit commitments¹
- spending more than 25% of gross income on consumer credit or
- spending more than 50% of gross income on consumer credit and mortgages.

At least 7% of households² were in one or more of these categories.

5 Clearly, consumers need to consider even more carefully before taking on more borrowing if their commitments have reached this level.

6 The results of the research have borne out the importance to minimising overindebtedness of the recommendations in the first report for greater sharing of

¹ “Credit commitments” is used to refer to outstanding consumer borrowing. It does not include mortgages (which are included in household bills) nor credit or store card balances which are unused or paid off by the due date.

² In 2000 there were 24.554 million households in the UK (Regional Trends)

data, including positive data, between lenders to enable them to make an informed assessment of the consumer's existing commitments, past payment performance and potential ability to repay. While many lenders already do so, it is clear that all lenders need to ensure that they consider all the available evidence about the consumer's commitments as a whole before extending new credit facilities or increasing the limits on existing facilities. Many lenders do not seek income data or information about non-credit commitments on all occasions. Often they would consider it disproportionate to do so given the size of the individual borrowing. Nevertheless, they have developed sophisticated systems for predicting consumers' ability to repay based on the available information. Analysis of the industry information available through credit reference agencies, which provides the basis for most lenders' lending decisions, suggests that borrowers with six or more active credit accounts³ and a balance of £500 or more on each of them are more likely to get into financial difficulties. Lenders should exercise particular care if their credit checking systems indicate that this or one or more of the indicators set out in paragraph 1.4 above will be exceeded by granting further credit.

7 But it is consumers who will be best placed to assess how their income and commitments measure up against the risk indicators. It is therefore important that the indicators should be included in advice to consumers from lenders, regulators and consumer advisers, along with tools to help consumers make the assessment. This report includes a template which can be used for such advice.

8 The research found evidence that some lending practices were associated with households in financial difficulty and with those that were heavily borrowed. None of these practices affected large numbers of people and it would be wrong to claim that they caused financial difficulties or over-borrowing. They do, however, disproportionately attract people who face these situations and have the potential to make a bad situation worse. It is, therefore, essential that lenders should act responsibly in using these techniques. In particular, they should not offer pre-approved loans, send unsolicited credit card cheques or make unsolicited increases in overdraft or credit card limits without first making appropriate checks to ensure that there is no evidence that the intended recipients are already in financial difficulty. Lenders should also consider carefully whether it is appropriate to offer inducements such as prize draws for the use of credit card cheques.

9 It is also crucial that lenders ensure that consumers understand the terms and conditions that will apply if they take up offers of credit made to them. To ensure this, lenders should provide customers with a clear statement of the charging arrangements and conditions of use of credit card cheques each time they send them. Those who sell payment protection insurance (PPI) should seek to ensure that the terms and conditions of the insurance are transparent to consumers and that the product is not sold to consumers who would be excluded by the terms of the policy from benefiting from it. In addition, there is a concern that not all consumers are aware that PPI stands apart from the credit agreement and is generally optional. A second signature should therefore be required for face-to-face sales. And where consumers transfer unsecured borrowing to a secured loan there should be a clear

³ Including mortgages and revolving credit that is repaid in full each month.

warning on the agreement that the home may be repossessed if repayments are not kept up.

10 However responsible both borrowers and lenders are, there will always be unexpected events which cause some consumers to get into financial difficulty. When they do, it is important that they should be treated sympathetically and positively. There is a key role for industry codes of practice in giving guidance to lenders on what this should mean in practice. In the case of the Banking Code separate guidance has been produced for subscribers which outlines how compliance with the principles of the Code can be demonstrated. The FLA is considering a similar initiative. Other industry codes should be reviewed to ensure that they provide appropriate guidance. At the same time, consumers and lenders can help avert problems by addressing them as early as possible. We would encourage consumers to approach their lenders to explain the problems they are experiencing and lenders to treat such approaches sympathetically and positively. In this way a mutually acceptable solution is more likely to be agreed.

11 Some cases will nonetheless result in court action. Where that is the case, consumers need to be aware of and understand the nature of the action and the options open to them. At the relevant stage in the process, lenders should provide consumers with information about the processes they will use to recover the debt and the options available to the consumer, including time orders. As part of its current review of enforcement procedures, the Lord Chancellor's Department should consider what more can be done to improve consumers' awareness of the options available to them.

12 Clear, succinct and transparent information about the terms and conditions of loans both before entering into an agreement and in the agreement itself is key to ensuring that consumers understand the commitments they are taking on, can assess their affordability and can compare different deals. A Working Group on prior information did much valuable work in identifying the key information consumers need and considering how this can best be presented to them, including some testing of consumer reactions. However, it was not an appropriate forum for reaching a solution to all the wide range of issues raised, including the requirements for statutory warnings. There is a need for a wide-ranging review of the statutory requirements on pre-contract information and on the format and content of credit agreements, which should draw on the lessons learnt from the Working Group and be a priority for DTI's current review of the Consumer Credit Act.

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