

Irresponsible lending

– OFT guidance for creditors

March 2010 (updated February 2011)

OFT 1107

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FOREWORD

The primary purpose in producing this guidance is to provide greater clarity for businesses and consumer representatives as to the business practices that the Office of Fair Trading (OFT) considers may constitute irresponsible lending practices for the purposes of section 25(2B) of the Consumer Credit Act 1974. It indicates types of deceitful or oppressive or otherwise unfair or improper business practices which, if engaged in by a consumer credit business, could call into consideration its fitness to hold a consumer credit licence.

Whilst this guidance represents the OFT's view on irresponsible lending, it is not meant to represent an exhaustive list of behaviours and practices which might constitute irresponsible lending.

The guidance is set out as follows and includes distinct chapters covering different stages in the lending process.

Chapter 1 outlines the scope and purpose of the guidance and our commitment to fair, effective and proportionate enforcement in considering conduct which does not appear to us to have regard to this guidance.

Chapter 2 outlines the overarching principles of consumer protection and fair business practice which, in our view, apply to all regulated consumer credit lending. We are providing this information in order that creditors might have regard to it in formulating their business practices and procedures.

Chapters 3 to 7 inclusive identify specific practices at various stages of the lending process which, in our view, may constitute irresponsible lending practices. Chapters 3 and 4 additionally provide further information regarding matters that we would take into account in forming a view as to whether a creditor was providing adequate explanations of credit agreements and/or conducting appropriate assessments of affordability, prior to making a credit agreement with a borrower.

Chapter 8 outlines our approach to securing regulatory compliance.

1 INTRODUCTION

The 'section 25 test'

- 1.1 The Consumer Credit Act 1974 and its subordinate legislation ('the Act') provide a framework to protect consumers when dealing with those engaged in consumer credit business and/or ancillary credit business.
- 1.2 All consumer credit businesses (creditors)¹ are required to hold an appropriate standard consumer credit licence issued by the Office of Fair Trading (OFT).² The OFT has a duty under section 25 of the Act to take steps to ensure that licences are only given to- and retained by- those who are fit to hold them (the 'section 25 test').
- 1.3 The licence should cover category A – 'consumer credit business'. As defined in section 189 of the Act, 'consumer credit business' means any business being carried on by a person so far as it comprises or relates to the provision of credit by him, or otherwise his being a creditor, under regulated consumer credit agreements. 'Creditor' means the person providing credit under a consumer credit agreement or the person to whom his rights and duties under the agreement have passed by assignment or operation of law, and in relation to a prospective consumer credit agreement, includes the prospective creditor.
- 1.4 Section 25 of the Act provides that, in considering fitness to hold a consumer credit licence, the OFT shall have regard to any matters which appear to it to be relevant and in particular any

¹ References to 'creditors' and 'consumer credit businesses', throughout this guidance document, are also generally applicable to their employees, agents or associates.

² Unless covered by an appropriate group licence.

evidence tending to show that an applicant, licensee, or its employees, agents or associates,³ past or present, have:

- committed offences involving fraud or other dishonesty or violence
- failed to comply with the Act or any other enactment regulating the provision of credit to individuals or other consumer protection legislation
- failed to comply with the requirements of Part 16 of the Financial Services and Markets Act 2000 so far as they relate to the consumer credit jurisdiction operated by the Financial Ombudsman Service
- practised discrimination in connection with the carrying on of their business
- engaged in business practices appearing to the OFT to be deceitful, oppressive or otherwise unfair or improper, whether unlawful or not.

1.5 Amongst the reforms introduced by the Consumer Credit Act 2006 was the inclusion of new provision section 25 (2B) of the Act which makes it explicit that amongst the business practices which the OFT may consider to be deceitful or oppressive or otherwise unfair or improper, for the purposes of the section 25 test, are practices in the carrying on of a consumer credit business that appear to the OFT to involve irresponsible lending.

³ Including business associates as referred to in section 25(3) of the Act - see Annex 1 to this guidance document.

- 1.6 The Act also requires that in determining whether a person is fit to hold a licence to operate a consumer credit business, the OFT shall have regard to the skills, knowledge and experience in relation to consumer credit businesses of that person and other persons who will participate in any business carried on by him under a licence and any practices and procedures to be implemented in connection with any such business.
- 1.7 In considering a person's fitness to hold a consumer credit licence, the OFT will take into account whether he has had regard to all relevant OFT guidance.
- 1.8 Section 25A of the Act requires the OFT to prepare and publish guidance in relation to how it determines, or proposes to determine, whether persons are fit to hold a consumer credit licence. The OFT must have regard to its guidance in carrying out its functions under the Act.

Enforcement principles

- 1.9 The OFT is committed to fair, effective and proportionate enforcement. In practice this means that where we identify non-compliance with the law and/or businesses failing to have regard to relevant OFT guidance, we will decide on the appropriate regulatory response in the light of the facts and circumstances of the individual case.
- 1.10 The type of OFT action taken will be guided by the level of actual or potential harm to borrowers and by the scale or frequency of identified misconduct. In considering whether conduct is non-compliant, we will take account of the statutory requirements at the time the conduct occurred.
- 1.11 Where we wish to change conduct, we will use one of the appropriate 'tools' available to us. For example, we can impose 'requirements' on a business where we are dissatisfied with any matter in connection with the operation of the licensed business.

Failure to comply with such a requirement can lead to the imposition of a financial penalty of up to £50,000 per instance of non-compliance. We may also compulsorily vary a licence, for instance to limit the activities for which a trader is licensed, or limit the life of the licence.⁴

- 1.12 In serious cases, where there is evidence tending to show that a person is unfit to hold a consumer credit licence, the OFT can take action with a view to refusing or revoking the credit licence of the person concerned. Engaging in irresponsible lending practices would constitute grounds for the OFT to consider fitness to hold a licence.
- 1.13 Any action taken by the OFT with a view to refusing or revoking a licence is subject to an independent decision making process. The licensee or applicant has a right to make representations to an independent adjudicator that the proposed action would be disproportionate or otherwise objectionable, prior to the adjudicator making a final decision. Following the final decision by the adjudicator, there is a further right to appeal the decision (if there is an adverse determination) to the Consumer Credit

⁴ The OFT can also take action under Part 8 of the Enterprise Act 2002 in respect of domestic or Community infringements falling within sections 211 or 212 of that Act. Our approach to the use of these powers is discussed in *Enforcement of consumer protection legislation – Guidance on Part 8 of the Enterprise Act (OFT512)*.

www.offt.gov.uk/shared_offt/business_leaflets/enterprise_act/oft512.pdf

We also co-ordinate such actions undertaken by other enforcers.

The OFT also has both civil and criminal enforcement powers under the Consumer Protection from Unfair Trading Regulations 2008.

www.offt.gov.uk/shared_offt/business_leaflets/cp/oft1008.pdf

Appeals Tribunal provided that there are appropriate grounds to do so.⁵

Regulated consumer credit agreements

- 1.14 In accordance with the definition of 'consumer credit business' in section 189 of the Act, this guidance applies to business practices so far as they comprise - or relate to - the provision of credit under a **regulated** consumer credit agreement. A consumer credit agreement is a regulated agreement if it is not an exempt agreement under sections 16, 16A, 16B or 16C of the Act.
- 1.15 Section 16 of the Act exempts various categories of agreement from regulation under the Act:
- Section 16A exempts certain agreements with high net worth borrowers.
 - Section 16B exempts agreements entered into wholly or predominantly for business purposes, provided that the amount of credit exceeds £25,000.
 - Section 16C exempts certain agreements relating to investment properties, including most 'buy-to-let' agreements.
- 1.16 The guidance also does not apply to agreements which were entered into prior to the removal of the financial limit in the Act in April 2008 which were for amounts above the financial limit.
- 1.17 Also amongst the exemptions are debtor-creditor agreements where the creditor is a **credit union** and the rate of the total

⁵ Further information about the adjudication process can be found in our guidance document *Licensing – your right to make representations (OFT661)*.

charge for credit (that is, the APR) does not exceed 26.9 per cent. This guidance does not apply to credit unions **provided** they do no regulated business (and consequently do not need a consumer credit licence).

- 1.18 The guidance also does not apply to first charge mortgage agreements regulated by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000.
- 1.19 Section 8 of the Act states that a consumer credit agreement is an agreement between an **individual** and any other person (the 'creditor') by which the creditor provides the debtor ('the borrower') with credit of any amount. In accordance with section 189 of the Act, an 'individual' includes a partnership consisting of two or three persons not all of whom are bodies corporate and an unincorporated body of persons which does not consist entirely of bodies corporate and is not a partnership. This guidance does not apply to agreements which are not between creditors and individuals, as defined in the Act.

Scope of the guidance

- 1.20 This guidance covers each stage of the lending process from the pre-contractual stage of advertising and marketing through to a consideration of issues such as the handling of arrears and default.
- 1.21 Although the guidance identifies business practices at each stage of the lending process which, in the OFT's view, may constitute 'irresponsible lending practices', it is not an exhaustive list of all possible behaviours which might constitute irresponsible lending. Given that this is the case and that the guidance can not anticipate all possible variants of behaviour and credit products, the OFT would expect creditors, to the extent that it is applicable to them, to have regard to both the letter and spirit of this guidance.

- 1.22 In the OFT's view, whether or not a particular practice might be considered to constitute an irresponsible lending practice may depend, in part, on the context in which the practice is engaged in, taking into account other related or linked practices. Some business models might incorporate irresponsible lending practices that do not lend themselves to being simply 'segmented' into constituent elements but might rather form parts of a continuum of improper practice. Consequently, the extent to which we may consider certain practices to constitute irresponsible lending practices will depend, to some degree, on individual circumstances and/or individual business models.
- 1.23 The guidance covers the key types of behaviour that we consider most relevant to a consideration of whether a creditor may be engaged in irresponsible lending, supplemented with some illustrative examples. A number of the behaviours relate to legal requirements (such as the requirement under section 55A of the Act for creditors to provide borrowers with adequate explanations prior to a credit agreement being made) whilst others are behaviours that we would consider to be improper even if not unlawful (such as taking steps to repossess a borrower's home, other than as a last resort).
- 1.24 It is not the case that all of the indicative examples of behaviours described in this guidance would in themselves automatically constitute grounds for OFT intervention. For example, a failure by a creditor to 'exercise forbearance' (see paragraph 7.4) would not necessarily constitute grounds for OFT intervention. However, the OFT would consider repeated and/or sufficiently serious cases of failure to exercise forbearance and/or acting unduly oppressively to constitute an improper and irresponsible lending practice that could call fitness into consideration.
- 1.25 The guidance does not cover all examples of what we might consider 'bad or undesirable practice' if such behaviours would not, in our view, **both** constitute irresponsible lending practices **and** provide grounds for the OFT to be dissatisfied and/or consider

the fitness of the business concerned to hold a consumer credit licence.

- 1.26 This guidance should be read in conjunction with other relevant OFT guidance, including *Consumer Credit Licensing – General guidance for licensees and applicants on fitness and requirements (OFT969)*,⁶ *Second charge lending – OFT guidance for brokers and lenders (OFT1105)*,⁷ *Debt Collection Guidance – Final guidance on unfair business practices (OFT 664)* and *Debt Management Guidance (OFT 366)*.⁸

Purpose of the guidance

- 1.27 The primary purpose of this guidance is to inform creditors of those behaviours that are likely to cause the OFT to consider fitness to hold a credit licence rather than to identify practices which, if conducted in isolation, might call into question the validity of individual agreements.
- 1.28 This guidance also provides a basis against which the OFT and its enforcement partners in Local Authority Trading Standards Services can undertake assessments of whether creditors have the appropriate skills, knowledge, experience, business practices and procedures, to be licensed by the OFT to operate a consumer credit business (the 'competence assessment').

⁶ www.offt.gov.uk/shared_offt/business_leaflets/credit_licences/oft969.pdf

⁷ www.offt.gov.uk/shared_offt/business_leaflets/general/oft1105.pdf

⁸ The OFT's Debt Collection Guidance (OFT 664) and Debt Management Guidance (OFT 336) set out types of behaviour that the OFT considers fall within the category of unfair business practices which will call into consideration fitness to retain or be given a licence. We would expect creditors, when handling default and arrears, to abide by both the letter and spirit of both of these guidance documents to the extent that they are applicable.

www.offt.gov.uk/shared_offt/business_leaflets/consumer_credit/oft664.pdf

www.offt.gov.uk/shared_offt/business_leaflets/credit_licences/oft366.pdf

- 1.29 It is part of the OFT's regulatory approach to seek to educate consumers through the provision of appropriate consumer guidance⁹ and we will continue to address issues relating to 'irresponsible borrowing' in this context. However, in the OFT's view, the extent to which irresponsible borrowing is made possible in some instances may, at least to some degree, be directly related to the effectiveness or otherwise of a creditor's business practices and procedures.
- 1.30 Borrowers also have a part to play in helping to better create an environment of sustainable credit provision. For example, where creditors' assessments of affordability rely, in part, on information provided by borrowers, it is important that such information is accurate and up to date and the borrower should advise the creditor in a timely manner of any relevant change of circumstances that is likely to significantly impact on any such assessment. Creditors would not be considered culpable by the OFT for placing reliance on information provided by borrowers, at least in part to inform such assessments, which was subsequently found to have been substantively inaccurate or untrue at the time that it was provided, where the creditor had no reason to suspect that this was the case.

⁹ www.consumerdirect.gov.uk/before_you_buy/money_and_credit/key-questions/

2 GENERAL PRINCIPLES OF FAIR BUSINESS PRACTICE

2.1 In the OFT's view there are a number of overarching principles of consumer protection and fair business practice which apply to all consumer credit lending.

2.2 In general terms, creditors should:

- not use misleading or oppressive behaviour when advertising, selling, or seeking to enforce a credit agreement
- make a reasonable assessment of whether a borrower can afford to meet repayments in a sustainable manner
- explain the key features of the credit agreement to enable the borrower to make an informed choice
- monitor the borrower's repayment record during the course of the agreement, offering assistance where borrowers appear to be experiencing difficulty and
- treat borrowers fairly and with forbearance if they experience difficulties.

2.3 In addition to the above there should be:

- **transparency** in dealings between creditors and borrowers, with information and documentation directed at - or provided to - borrowers being compliant with relevant legislative requirements and not being in any way misleading

This would include - but not be limited to - all advertising and marketing materials, web-sites and pre- and post-contract information. This principle applies to documents and information provided throughout the credit cycle and regardless of whether they are directed at potential borrowers or existing customers.

- disclosure of key contract terms and conditions (including rates and charges), ensuring terms and conditions are **fair** (including ensuring that they are not unfairly balanced in favour of the creditor), **clear** and **intelligible**, so as to be understandable by borrowers

The OFT expects all pre-contract and contract documentation to comply with all relevant legislative requirements including the Consumer Credit (Disclosure of Information) Regulations 2010 and the Consumer Credit (Agreements) Regulations 2010¹⁰ and the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs).¹¹

The UTCCRs apply a test of fairness to terms which have not been individually negotiated in contracts between businesses and consumers. There is an exemption for terms which are 'core terms' (terms that set the price or describe the main subject matter of the contract) provided that they are in plain and intelligible language. Contract terms should not be unfairly balanced in favour of the creditor to the potential detriment of the borrower. Contractual imbalance may arise to the detriment of the borrower where a term gives powers or safeguards to the creditor which could put the borrower at a disadvantage whether or not actual harm is currently being caused.

- **fair treatment of borrowers.** Borrowers should not be targeted with credit products that are clearly unsuitable for them, subjected to high pressure selling, aggressive or oppressive behaviour or inappropriate coercion, or conduct which is deceitful, oppressive, unfair or improper, whether unlawful or not

¹⁰ Separate requirements apply in respect of loans secured on land.

¹¹ www.opsi.gov.uk/si/si1999/19992083.htm

Borrowers who may be particularly vulnerable by virtue of their current indebtedness, poor credit history, or by reason of age or health, or disability, or for any other reason, should, in particular, not be targeted or exploited.

- **forbearance and consideration** towards borrowers experiencing difficulty. We would expect creditors to work with such borrowers with a view to providing them with reasonable time and opportunity to meet repayments
- **proportionality** in dealings between creditors and borrowers. Actions taken in respect of arrears or default should give proper consideration to available options with **repossession of a borrower's home only being used as a last resort**.

2.4 Section 25(2) of the Act states that the OFT shall have regard to the business practices and procedures implemented in connection with consumer credit businesses in determining fitness for the purposes of the section 25 test. When formulating their business practices and procedures, in order to facilitate the avoidance of engaging in irresponsible lending practices, we would expect creditors to have regard to these general principles and to give effect to their practices and procedures in such a way as to facilitate these general principles being followed in practice.

3 EXPLANATIONS OF CREDIT AGREEMENTS

Although the specific legal requirements of section 55A of the Act **do not apply** to certain categories of regulated credit agreement¹² – including those secured on land – we would expect all creditors to consider the extent to which the **principles** outlined in this chapter may be applied to all aspects of their regulated consumer credit business. For example, before an agreement is made, we would expect all creditors to consider highlighting key risks to the borrower such as the potential consequences of missing payments or under-paying – including the risk of repossession of property on which a loan is secured where applicable.

3.1 In accordance with the requirements of section 55A(1) of the Act, before a regulated consumer credit agreement, other than an excluded agreement, is made with a borrower, the creditor must:

- provide the borrower with adequate explanation of the matters referred to in section 55A(2) of the Act in order to place him in a position enabling him to assess whether the agreement is adapted to his needs and his financial situation
- advise the borrower to consider the information which is required to be disclosed under section 55(1) of the Act and where this information is disclosed in person to him, that he is able to take it away

Section 55(1) of the Act requires specified information to be disclosed to borrowers in the manner prescribed in regulations, before a regulated agreement is made.

¹² The requirement in section 55A of the Act to provide pre-contractual explanations does **not** apply to regulated agreements under which the creditor provides the borrower with credit exceeding £60,260, loans secured on land or overdraft agreements (**except** those for non-business purposes where the credit is not repayable on demand or within three months).

- provide the borrower with an opportunity to ask questions about the agreement and
- advise the borrower how to ask the creditor for further information and explanation.

3.2 The matters referred to in section 55A(2) of the Act are:

- a) the features of the agreement which may make the credit to be provided under the agreement unsuitable for particular types of use
- b) how much the borrower will have to pay periodically and, where the amount can be determined, in total under the agreement
- c) the features of the agreement which may operate in a manner which would have a significant adverse effect on the borrower in a way which the borrower is unlikely to foresee
- d) the principal consequences for the borrower arising from a failure to make payments under the agreement at the times required by the agreement, including legal proceedings and, where this is a possibility, repossession of the borrower's home and
- e) the effect of the exercise of any right to withdraw from the agreement and how and when this right may be exercised.

3.3 The OFT expects creditors to adopt a **proportionate** approach to the provision of explanations of credit products to borrowers. Nevertheless, the law requires that the explanation provided should be adequate to place the borrower in a position enabling him to assess whether the agreement is adapted to his needs and his financial situation.

In the OFT's view, the explanation should enable the borrower to make a reasonable assessment as to whether he can afford the credit and to understand the key associated risks.

3.4 In our view, in deciding on the level and extent of the explanation to be provided, the creditor, his representatives, agents or 'relevant third parties'¹³ should consider, to the extent that it is appropriate to do so and having regard to the relevant legal requirements, a number of factors including:

- **the type of credit being sought** - The features of different types of credit product may require different levels of explanation
- **the amount of credit to be provided and the associated cost and risk to the borrower** - The risk to the borrower is likely to be greater the higher the total cost of the credit relative to his financial situation
- **the apparent level of understanding of the borrower of the explanation provided (to the extent that this is evident and discernable)** - Some borrowers are likely to need different levels of- and types of- explanation

In appropriate circumstances such as, for example, when a borrower does not have a good understanding of the English language, the creditor may need to present relevant information and explanation to third party representatives such as friends or relatives of the borrower who have a good command of English.

This would allow the borrower to use such third parties (in addition to creditor-provided resources) to assist him in understanding the explanation provided.

- **the channel/medium through which the credit transaction takes place** - For example, 'face to face'

¹³ For example independent brokers.

transactions in the home or in a retail outlet, or those which take place by telephone, may better afford the borrower the opportunity to ask questions and/or seek clarification than those which take place at a distance and without direct contact e.g. over the internet.

- 3.5 The contents of paragraphs 3.6 to 3.13 inclusive should be considered as general statements by the OFT that we would expect creditors to have regard to when formulating their practices and procedures for providing adequate explanations to borrowers and when giving effect to those practices and procedures in accordance with the requirements of section 55A of the Act.

Adequate explanations

- 3.6 The OFT would not consider an explanation to be 'adequate' where the creditor had not made reasonable provision to ensure that borrowers were likely to understand the explanation of the matters specified in section 55A(2) of the Act and/or where the creditor had clear grounds to suspect that the borrower did not understand key aspects of the explanation. Under circumstances in which the creditor has clear grounds to suspect that the explanation provided has not placed the borrower in a position whereby he is enabled to assess whether the agreement is suited to his needs and his financial situation, we would expect further explanation to be provided.

It is accepted that the use of remote channels, such as the internet, by their nature, limit the creditor's ability to take a view on the borrower's level of understanding of explanations provided.

Given that creditors employing the use of such channels will need to advise borrowers how they can ask for further information and explanation (in accordance with the requirement of section 55A(1)(d) of the Act)¹⁴, they **might**, for example, wish to consider providing (local rate) telephone contact details for those borrowers who may wish to seek further information and explanation.

3.7 Creditors can give advice and explanation to borrowers orally or in writing except as provided for in section 55A(4) of the Act. This states that where the explanation of any of the matters specified in paragraphs (a), (b) or (e) of section 55A(2)¹⁵ is given orally (but not necessarily in person - for example where the transaction takes place in whole or in part over the telephone) or in person (for example in a face-to-face transaction in a retail outlet) to the borrower, the explanation of the other matters specified in section 55A(2) of the Act and the advice required to be provided in accordance with section 55A(1)(b) of the Act must be provided **orally** to the borrower before the consumer credit agreement is made (even where written explanations are also provided). Consequently, where these criteria are met, creditors must:

- orally advise a borrower to consider the information which is required to be disclosed to him under section 55(1) of the Act and, where this information is disclosed in person to him, that he can take it away with him
- orally explain to a borrower the features of the agreement which may operate in a manner which would have a significant adverse effect on him in a way which he is unlikely to foresee and

¹⁴The requirement under section 55A(1)(d) of the Act does not apply to a regulated agreement under which a creditor takes an article in 'pawn'.

¹⁵ The matters specified in paragraphs (a), (b) and (e) of section 55A(2) are shown in paragraph 3.2 of this guidance with the same letters as in the relevant paragraphs in the Act.

- orally explain to a borrower the principal consequences for him arising from a failure to make payments under the agreement at the times required by the agreement including legal proceedings and, where this is a possibility, repossession of his home.

In accordance with section 185(1A) of the Act (relating to agreements with more than one borrower), the requirement to provide orally explanations and advice in accordance with section 55A(4) does not apply to any borrower to whom an explanation of the matters referred to in paragraphs (a), (b) or (e) of section 55A(2) has not been given orally or in person.

- 3.8 We believe that there needs to be an opportunity for a degree of 'interactivity' between the borrower and the creditor such that the borrower is afforded the opportunity, before entering into the agreement, to obtain answers to questions about the proposed agreement, in accordance with the requirement of section 55A(1)(c) of the Act.

In respect of on-line applications, we consider that the objectives of this 'interactive' component could be achieved, for example, by the borrower being able to obtain access to an appropriately comprehensive online 'FAQ' on the creditor's web-site or by being able to speak to a representative of the on-line provider. This interactive component is important where credit is entered into online since otherwise, in our view, creditors may not be able to meet the full requirements of section 55A(1) of the Act.

- 3.9 In the case of telephone or face-to-face transactions in particular, the opportunity for interactivity between the borrower and the creditor should better enable the creditor to form a view as to whether the borrower has been placed in a position enabling him to assess whether the agreement is adapted to his needs and is affordable given his financial situation - or whether further explanation should be provided. It is unlikely, in our view, that this could be achieved solely by providing the borrower with a written pro-forma.

- 3.10 The fact that a borrower might state or imply that he does not require an explanation of the credit product does not absolve the creditor from the legal responsibility of providing an adequate explanation. The creditor should not encourage the borrower to waive his right to a full explanation.
- 3.11 In accordance with the requirements of section 55A(5) of the Act, the creditor would **not** be required to provide a pre-contractual explanation to a borrower under circumstances in which the borrower had already been provided with an adequate explanation by a credit intermediary in respect of the agreement, in a manner which complies with the requirements of sections 55A(1) to 55A(4) of the Act.

See section 160A of the Act for a legal definition of what constitutes a 'credit intermediary'.

The OFT would expect the creditor to take reasonable steps to satisfy itself that an adequate explanation, meeting the requirements of section 55A of the Act, had indeed been provided by a credit intermediary to the borrower in respect of a particular regulated agreement before determining that the requirements of sections 55A(1) to 55A(4) of the Act were not applicable to it (the creditor) in respect of that agreement.

- 3.12 An adequate explanation should be given for each new regulated consumer credit agreement before it is made (including any modifying agreement).¹⁶

¹⁶ This is deemed to give rise to a new agreement by virtue of section 82(2) of the Act.

Constituent elements of the pre-contractual explanatory process

3.13 The creditor should inform the borrower of the following:

The features of the agreement (if any) which may make the credit to be provided under the agreement unsuitable for particular types of use

For example, the OFT would expect that, where applicable, the borrower should be informed that the credit being sought is a short-term loan product, unsuitable for supporting sustained borrowing over longer periods, and would be expensive as a means of longer term borrowing e.g. a payday loan.

How much the borrower will have to pay under the agreement

In the OFT's view, consideration should be given to providing explanations to the borrower of those of the following which appear to the creditor to be appropriate/applicable given the nature of the credit being sought:

- The total amount payable under the agreement (where this can be determined) and
- how much is payable each repayment period and the number and frequency of repayments.

The pre-contractual information should take account of any preferences expressed or information supplied by the borrower. Subject to this, the information – in particular the APR and total amount payable – may be 'representative' of the credit product offered.

We consider that borrowers should be able to shop around for credit without a footprint being left on their credit files which could impair their credit rating. This would be facilitated by creditors undertaking 'quotation searches', as distinct from 'application searches', when appropriate to do so.

The principal consequences for the borrower of not keeping up with repayments

In our view, the risk of the following should be explained to the borrower, where applicable:

- The total cost of the debt growing
- incurring default charges and interest where applicable

This would include charges for late payment, missed payment or under-payment. In the OFT's view, the explanation should at least give an indication to the borrower of what the approximate level of charges or interest would be likely to be.

- impaired credit rating leading to credit being more difficult or more expensive to acquire in the future
- legal proceedings (including court action and associated costs)
- application for bankruptcy, charging order or order for sale

In **Scotland**, creditors may alternatively use an 'inhibition' (as opposed to a charging order) as a means of enforcing a debt. If a creditor takes out an inhibition against a borrower who owes it money, the inhibition prevents the borrower from selling or transferring ownership of his home or taking out any further loans secured on his home. An 'adjudication' is a transfer of property from a borrower to a creditor in payment of a debt.

- repossession of the borrower's home (or other property where applicable) and
- a pledge will be sold if not redeemed (in respect of a regulated agreement under which a creditor takes an article in 'pawn').

In respect of a regulated agreement under which a creditor takes an article in pawn, the explanation the creditor needs to provide to the borrower (in accordance with the requirements of section 55A(7) of the Act) **only** needs to cover:

- a) the principal consequences for the borrower arising from a failure to make payments under the agreement at the times required by the agreement and
- b) the effect of the exercise of any right to withdraw from the agreement and how and when this right may be exercised.

The explanation of a) above (covering the principal consequences of not keeping up with repayments) must be provided to the borrower **orally** where the explanation of b) above (covering the exercise of any right of withdrawal) is given orally or in person to the borrower. The borrower must also be provided with an opportunity to ask questions about the agreement (in accordance with the requirement under section 55A(1)(c) of the Act).

The right of withdrawal

The creditor should inform the borrower of the effect of the exercise of any right of withdrawal from the agreement and how and when this right may be exercised.

The right of withdrawal under section 66A of the Act applies to all regulated consumer credit agreements except where the agreement is:

- a) for credit which exceeds £60,260
- b) a credit agreement secured on land
- c) a restricted-use credit agreement to finance the purchase of land
- d) an agreement for a bridging loan in connection with the purchase of land or
- e) an overdraft agreement (except for overdrafts for non-business purposes where the credit is not repayable on demand or within

three months).

Borrowers have a period of 14 calendar days (from the date calculated in accordance with section 66A(3) of the Act) in which to withdraw from a credit agreement without giving any reason.¹⁷

The features of the agreement which may operate in a manner which would have a significant adverse effect on the borrower in a way which the borrower is unlikely to foresee

The following are amongst the features associated with a credit agreement that, **in the OFT's view**, should be included, where applicable, in an explanation to a potential borrower who was considering acquiring any of the following credit products (in addition to the information detailed above):

Credit and store cards

- Different rates and/or charges may apply to different elements of the credit (for example, the higher cost of withdrawing cash)
- the implications of only making minimum repayments
- interest rates charged may be increased both as a result of rate changes which are applicable to all borrowers and on the basis of the creditor's view that the 'risk profile' of an individual borrower has changed (where applicable)

We consider that there should be transparency about the circumstances in which any variable rates or charges may change, in particular where they are not linked to the Bank of England base rate.

¹⁷ Where this right of withdrawal does not apply, the borrower may have a separate right of cancellation either under the Act or under the Financial Services (Distance Marketing) Regulations 2004 (which continue to apply to distance contracts not covered by the right of withdrawal – subject to its own exclusions).

The regulations made under section 55(1) of the Act require an indication of the periods, conditions and procedure for varying the interest rate.

- limitations on a 0 per cent or other introductory offer
- conditions in relation to balance transfers including any fees or charges which may apply.

Credit card cheques

- The higher associated costs relative to payment by credit card.

Home credit

- The effect of extending the life of a credit agreement or 'rolling over' loans.

Payday loans

- The effect of extending the life of a credit agreement or 'rolling over' loans.

Bills of sale¹⁸

- The risk of losing the asset (usually a vehicle) on which the credit is secured, how it would be repossessed, and the loss this could entail
- repossession under a Bill of Sale can take place without a court order
- repossession may not clear all the debt owed
- unlike under a hire-purchase agreement, there is no protection from repossession having paid off a third of the amount owed or provision for voluntary termination.

¹⁸ In so far as these constitute regulated consumer credit agreements.

Linked credit (hire-purchase and conditional sale)

- The borrower does not own the goods until he has paid off the agreement, including any 'option to purchase' fee
- goods can be repossessed in the event of default unless the borrower has paid a third or more of the total amount payable.

Where a third or more of the total cost has been paid, the goods become 'protected' and the creditor would require a court order to take repossession. The borrower also has a right to voluntarily terminate the agreement at any time before the last instalment is due, provided that he has paid, or pays up to, half of the total amount payable.

Consolidation loans

- Where applicable (and known to the lender and calculable), consolidating existing debts will involve the payment of higher interest rates and/or charges (increasing the total amount payable) and/or will increase the repayment period.
- Where applicable, that the credit would be secured on the borrower's property.

The advisability of the borrower considering the pre-contract information which is required to be disclosed to him and where this information is disclosed in person to him, his ability to take the information away

Borrowers should be provided with pre-contract information in the form and manner required by law according to whether the contract is distance or non-distance.

In the case of non-distance contracts, pre-contract information should be provided in writing by means of the pre-contract credit information form (also known as the Standard European Consumer Credit Information form or SECCI),¹⁹ where applicable.

The relevant regulations do not apply to agreements secured on land, distance contracts, agreements for credit exceeding £60,260 or agreements wholly or predominantly for business purposes.

They also do not apply to pawn agreements except where:

- a) the creditor has received a request from the borrower for information about the prospective agreement or
- b) the borrower is a 'new customer' i.e. he has not entered into a pawn agreement with the creditor within the previous three years.

More limited information is required in respect of overdraft agreements and the pre-contract credit information form does not have to be used in such cases.

The borrower can seek further information and explanation about the agreement

The creditor should provide the borrower with an opportunity to ask questions about the credit agreement. The creditor should also advise the borrower how to ask for further information and explanation about the credit agreement from him.

¹⁹ See Schedule 1 to the Consumer Credit (Disclosure of Information) Regulations 2010.

Specific irresponsible lending practices

- 3.14 Set out below are examples of practices that the OFT considers may, depending on the exact circumstances, amount to irresponsible lending.

Unsatisfactory business practices and procedures

- 3.15 Failing to establish and implement clear and effective policies and procedures for the provision of adequate explanations (as required in accordance with section 55A(1)(a) of the Act).

In the case of regulated agreements under which a person takes an article in pawn, the creditor will need to ensure that its policies and procedures are sufficient to meet the requirements of section 55A(7) of the Act.

Creditors selling credit products via the internet, for example, would need to ensure that a borrower was not able to enter into a credit agreement with them without them first providing the borrower with an adequate explanation of the features of the credit agreement and an opportunity to ask questions, as required by section 55A(1) of the Act. In the OFT's view, this **may** necessitate some creditors having to amend the way their systems are set up.

In our view, the legal requirement under section 55A(1) of the Act may not be met unless the borrower, prior to making the agreement with the creditor, has to pass through screens containing the required information and explanations, affording the borrower the opportunity to see and read the explanations provided. We consider that simply directing the borrower to where he can click-through to where the explanation can be found, by the use of appropriate 'links', **may not** constitute 'providing the borrower with an adequate explanation' for the purposes of section 55A(1) of the Act.

- 3.16 Failing to implement procedures to enable borrowers to be able to ask for- and obtain ready access to- further information or explanation about the agreement.

In the OFT's view, this requirement would not be met if the borrower had to incur unreasonable costs and/or experienced undue delay in accessing the information or explanation.

Transparency

- 3.17 Failing to provide a borrower with **any** explanation of the credit agreement being considered prior to granting credit.
- 3.18 Failing to provide a borrower with an explanation which is **adequate** within the meaning of section 55A(1) of the Act.
- 3.19 Failing to provide a borrower with an opportunity to **ask questions** about the agreement in accordance with section 55A(1)(c) of the Act.
- 3.20 Failing to provide an adequate **oral** explanation in accordance with- and to the extent required by- section 55A(4) of the Act.

This does not preclude the provision of written information when explanation of the credit product is provided either in person to the borrower or orally (but not in person) to the borrower – but this would need to be supplemented by an appropriate oral explanation in accordance with legal requirements.

- 3.21 Failing to communicate to the borrower the features of the agreement (if any) which may make the credit to be provided under the agreement unsuitable for particular types of use in accordance with the requirements of section 55A(2)(a) of the Act.
- 3.22 Failing to communicate to the borrower how much he will have to pay periodically and, where the amount can be determined, in total under the agreement, in accordance with the requirements of section 55A(2)(b) of the Act.
- 3.23 Failing to communicate to the borrower the features of the credit agreement which may operate in a manner which would have a significant adverse effect on the borrower in a way which the

borrower would be unlikely to foresee, in accordance with the requirements of section 55A(2)(c) of the Act.

- 3.24 Failing to communicate to the borrower the principal consequences for him arising from a failure to make payments under the agreement, at the times required by the agreement – including legal proceedings and repossession of the borrower's home where this is a possibility- in accordance with the requirements of section 55A(2)(d) of the Act.
- 3.25 Failing to communicate to the borrower the effect of the exercise of any right to withdraw from the agreement and how and when this right may be exercised, in accordance with the requirements of section 55A(2)(e) of the Act.
- 3.26 Failing to advise the borrower to consider the information which is required to be disclosed to him under section 55(1) of the Act and where this information is disclosed in person to him, that he is able to take it away, in accordance with the requirements of section 55A(1)(b) of the Act.

Borrowers are advised to read the information carefully and give due consideration to the explanations provided in order to satisfy themselves that they understand the key features of the credit agreement and associated risks, prior to entering into it.

- 3.27 Failing to advise the borrower how to ask the creditor (or a person acting for the creditor) for further information and explanation in accordance with the requirements of section 55A(1)(d) of the Act.
- 3.28 Providing explanations, orally or in writing, which place insufficient emphasis on the features of the credit agreement which may operate in a manner which would have a significant adverse effect on the borrower in a way which the borrower might not foresee.

Features of the credit agreement which carry a particular risk to the borrower should be highlighted.

For example, it should be explained to borrowers of unsecured loans that in the event of default, even an unsecured loan could ultimately result in a charge being placed on the borrower's home – unless it is not, and will not be, part of the creditor's enforcement policy to seek charging orders (or inhibitions in Scotland), orders for sale, bankruptcy or repossession.

Physical/psychological harassment

3.29 Pressurising a borrower to sign up to a credit agreement without affording him a reasonable opportunity to do the following:

- ask questions about the agreement
- consider the information provided by the creditor about the agreement and, where applicable and appropriate, to take the information away and
- ask for and obtain further information and explanation.

Borrowers should be permitted to take the information provided away to further consider it and/or the explanations provided should they wish to do so.

They should similarly be permitted to make further enquiries (for example to see what other creditors are offering or to seek guidance from a money advisor or another independent third party) should they wish to do so.

Creditors should not actively discourage a borrower from doing any of the above - in particular under circumstances in which the borrower has indicated to the creditor that he wishes to do one or more of the above before entering into the credit agreement.

3.30 Pressurising or requiring a borrower to acknowledge, in writing or by any other means, that he has been provided with an **adequate** explanation.

This would include requiring the borrower to 'tick a box' or take some other form of action which has the same effect in terms of providing an 'acknowledgement'. However, this would not preclude the creditor from simply asking the borrower if he has understood the explanation provided.

In the OFT's view, it is acceptable for borrowers to be required to acknowledge in writing that they have been provided with **an explanation** of the credit product by the creditor or his representative (provided that this was the case) – and/or that they have been provided with a copy of written information which constituted all or part of any such explanation.

However, the borrower should not be required to provide a formal acknowledgement that any such explanation was **adequate** since the borrower may not be in a position to know with any certainty at that stage whether the explanation provided was adequate or not.

Deceptive and/or unfair practices

- 3.31 Providing incorrect and/or untrue information or explanations to borrowers under circumstances when the creditor knows, or ought to have known, that the information or explanation provided is incorrect and/or untrue.

Information or explanations may be rendered incorrect and/or untrue by either act or omission.

- 3.32 Contending that an explanation complying with the requirements of section 55A of the Act had already been provided to the borrower by a credit intermediary when this is not the case.

The creditor would not be considered culpable in this regard if it had taken reasonable steps to ascertain whether the credit intermediary had provided such an explanation and it had been misled by the intermediary. Under such circumstances the OFT would consider taking appropriate action against the credit intermediary.

4 ASSESSMENT OF AFFORDABILITY

- 4.1 **In the OFT's view**, all assessments of affordability should involve a consideration of the potential for the credit commitment to adversely impact on the borrower's financial situation, taking account of information that the creditor is aware of at the time the credit is granted. The extent and scope of any assessment of affordability, in any particular circumstance, should be dependent upon- and **proportionate** to- a number of factors (see paragraph 4.10 of this guidance document).

'Assessing affordability', in the context of this guidance, is a 'borrower-focused test' which involves a creditor assessing a borrower's ability to undertake a specific credit commitment, or specific additional credit commitment, in a sustainable manner, without the borrower incurring (further) financial difficulties and/or experiencing adverse consequences.

- 4.2 Whatever means and sources of information creditors employ as part of an assessment of affordability should be sufficient to make an assessment of the risk of the credit sought being **unsustainable** for the borrower in question. In our view this is likely to involve more than **solely** assessing the likelihood of the borrower being able to repay the credit in question. We consider that before granting credit, significantly increasing the amount of credit, or significantly increasing the credit limit under an agreement for running account credit, creditors should take reasonable steps to assess a borrower's likely ability to be able to meet repayments under the credit agreement **in a sustainable manner**.

The OFT encourages the sharing of data between creditors subject to data protection and other legal considerations. The process of assessing affordability is assisted by creditors registering accurate data with credit reference agencies, in a timely manner, about the performance of an account and/or settlement of outstanding debts/arrears.

Borrowers are encouraged to always undertake **their own** assessment of affordability concurrent with that undertaken by the creditor.

- 4.3 The OFT regards 'in a sustainable manner' in this context as meaning credit that can be repaid by the borrower:
- without undue difficulty – in particular without incurring or increasing problem indebtedness
 - over the life of the credit agreement or, in the case of open-end agreements, within a reasonable period of time
 - out of income and/or available savings, without having to realise security or assets.
- 4.4 The OFT would regard 'without undue difficulty' in this context as meaning the borrower being able to make repayments (in the absence of changes in personal circumstances that were not reasonably foreseeable at the time the credit was granted):
- while also meeting other debt repayments and other normal/reasonable outgoings and
 - without having to borrow further to meet these repayments.
- 4.5 We consider that all assessments of affordability should be based on the premise that the borrower should be able to repay the credit over the term. It is accepted that providers of open-end credit, where there is no fixed term, will be limited in their ability to be able to make an assessment of whether repayments might be met in a sustainable manner **over the whole life of the credit agreement** – but they should be able to make a reasonable assessment of sustainability **at the time the credit agreement is entered into** (and on the basis of reasonable assumptions regarding the likely duration of any drawdown). The creditor's assessment should have regard to the borrower's ability to pay

off the maximum amount of credit available (equivalent to the credit limit) over a reasonable period of time.

- 4.6 The OFT cannot stipulate exactly what will constitute a 'reasonable period of time' for this purpose as this will vary from case to case depending on the circumstances of the borrower and the amount of the credit. However, in the OFT's view, in the case of running account credit, the borrower should be able to repay the credit on a timeline at least akin to that used for other forms of unsecured lending such as fixed sum personal loans, made for an amount equivalent to the credit limit. If there was no realistic likelihood, based on an affordability assessment, that a borrower would have been capable of paying off an outstanding balance within a reasonable period of time if he spent up to his credit limit, then we are likely to consider this to constitute irresponsible lending on the grounds that the borrower has been provided with clearly inappropriate credit. The fact that a borrower may be able to 'service a debt' over many years simply by making minimum repayments does not, in our view, equate to being able to pay off a debt in a reasonable period of time.

We consider that the credit limit should have been set by the creditor (presumably aware of the borrower's current disposable income and any reasonably foreseeable future changes in the level of his disposable income - for example, if the borrower is close to retirement age and facing a significant fall in disposable income) on the basis of having undertaken an appropriate affordability assessment.

- 4.7 The OFT would not necessarily consider repayments to be unsustainable simply because the borrower may miss an occasional payment as it falls due. However, under such circumstances, we would not expect creditors to:
- extend **formally** the duration of the agreement i.e. we would expect creditors to allow for missed repayments to be made up at a later date (within the original term of the loan or otherwise accommodated) or

- where the duration of the agreement is formally extended, increase the total amount payable to unsustainable levels or otherwise cause an adverse impact on the borrower's overall financial situation.

4.8 Where the assessment of affordability suggests that a borrower is unlikely be able to meet repayments under a credit agreement in a sustainable manner over the life of the agreement, in our view, it should not be made available for that amount and duration. However, a smaller amount of credit, for example, may be sustainable (based on the assessment of affordability).

4.9 In certain limited circumstances (such as when it is **known** that there will be a fixed period of **short term** temporarily reduced income i.e. it is known when this period of reduced income (or no income) will end and what the approximate level of income will be at the end of this period), we consider that it **might** be reasonable to grant credit that, on the basis of an affordability assessment, is not **immediately** sustainable – provided that under such circumstances repayment periods are agreed in advance and appropriate forbearance²⁰ is applied in respect of borrowers who may not be in a position to meet initial repayments.

In our view, this limited exception would be less likely to apply where the fixed period of reduced income was likely to span an extended period²¹.

²⁰ This **might** include, for example, allowing for deferment of repayment or waiving penalties in certain instances.

²¹ See subsection entitled 'Student Lending' in **OFT 1107resp - Summary of responses to the consultation on 'Irresponsible Lending – OFT Guidance for Creditors**. The OFT does **not** consider allowing for the deferment of repayment of student loans provided by Local Education Authorities to constitute irresponsible lending. We similarly do not consider allowing for the deferment of repayment of Government-backed Professional and Career Development Loans to fund higher/further education and to enhance career prospects to constitute irresponsible lending (subject to appropriate assessments of affordability being carried out by the creditor before the credit agreement is made). In our view, the same consideration is **less likely** to apply to other

Constituent elements of an assessment of affordability

4.10 As previously stated, in the OFT's view, the extent and scope of any assessment of affordability, in any particular circumstance, should be dependent upon- and **proportionate** to- a number of factors - which **may** include some or all of the following as appropriate:

- the type of credit product
- the amount of credit to be provided and the associated cost and risk to the borrower
- the borrower's financial situation at the time the credit is sought
- the borrower's credit history including any indications of the borrower experiencing- or having experienced- financial difficulty

A creditor may have an existing financial relationship with the borrower that could help to inform this aspect of the assessment. For example, it may have a long-standing financial relationship with the borrower that has been satisfactorily discharged on both sides.

- the borrower's existing and future financial commitments including any repayments due in respect

forms of lending to students – for example in respect of the provision of credit facilities which might facilitate an unduly high level of consumption of goods or services in respect of which repayments would not be sustainable. This is because such credit facilities are **less likely** to afford borrowers an equivalent level of in-built protection from an affordability perspective (including **the extent of the forbearance** applied to the pursuance of initial repayments) to that afforded by providers of SLs and PCDLs provided certain appropriate criteria are met.

of other financial products²² and significant non-credit commitments

We would only expect a creditor to take account of 'future financial commitments' of which it is **aware**. However, we would expect it to take reasonable steps to obtain relevant information.

We do not consider that the creditor could be held culpable under circumstances in which it made a reasonable request for information from the borrower, in order to inform its assessment of affordability, and the information provided by the borrower was substantively incorrect/untrue and the creditor (acting reasonably) was not aware of this.

'Significant non-credit commitments' would include, for example, payments relating to rent, council tax, utility bills and hire etc.

- the impact of a future change in the borrower's personal circumstances: for example, this could include a known end date of current employment due to circumstances such as retirement or the end of a fixed term employment contract - either of which may lead to a fall in the borrower's disposable income. The **possibility** of being made redundant, when it was not **known** at the time that the assessment of affordability was undertaken that this would happen, would not be a matter that the OFT considers creditors could be reasonably expected to take into account
- the vulnerability of the borrower: for example, whether the borrower is known to lack - or is reasonably believed to lack - the mental capacity to be able to understand information and explanations provided to him and make informed borrowing decisions based on his

²² Including any first charge mortgage.

understanding of such information and explanations at the time they are provided.

Amongst those groups who **may** lack mental capacity to an extent that it might impact on their ability, at certain times, to understand information and explanations relating to financial products and/or effectively communicate any concerns they may have regarding such products, are those with specific mental health issues, those with learning disabilities and those with autism spectrum disorder (ASD).

4.11 The OFT accepts that it would be disproportionate to require creditors to consider **all** of these factors in **all** cases. The creditor should take a view on what is appropriate in any particular circumstance dependent on, for example, the type and amount of the credit being sought and the potential risks to the borrower.

4.12 Creditors may employ the use of a variety of types and sources of information to assess affordability which **might**, depending on the circumstances, include some or all of the following examples (this is a non-exhaustive list):

- record of previous dealings with the borrower
- evidence of income
- evidence of expenditure
- a credit score
- a credit report from a credit reference agency
- information obtained from the borrower, whether on an application form or separately (this would include information derived from 'personal contact' with the borrower – for example, during a meeting with a potential borrower at his home).

Paragraph 4.12 is not a **checklist** of sources of information that we consider creditors **must** use – but a list of examples of the types and sources of information that **might** be appropriate. In our view, creditors may apply their own discretion (acting reasonably) in deciding the types and sources of information they employ to assess affordability. However, it may subsequently be incumbent on them to provide to the OFT such documents and information as the OFT requests relating to the practices and procedures that they employ for assessing affordability (for example where the OFT requests documents pursuant to sections 36B or 36C of the Act) to enable the OFT to form a view as to whether the practices and procedures that they employ for assessing affordability are effective.

4.13 In the OFT's view, **if** creditors take **income** into account in assessing affordability, such considerations should take account of both actual current income and reasonably expected future income (to the extent that it is proportionate to do so) where it is reasonably foreseeable that the latter will materially differ from the former over the anticipated repayment period of the credit agreement. All assessments should be based on what is **known** at the time the assessment is undertaken. However, caution should be exercised, where appropriate, before presuming that supplementary income, being received at the time the assessment is being undertaken, will continue to be received in perpetuity (or received at the same level), in circumstances where this is not guaranteed. For example, it may not be reasonable to assume that a borrower will continue, year on year, to receive an annual performance related bonus from his employer which is equivalent to that of previous years or to assume that the borrower will continue to receive current overtime payments indefinitely and/or of the same amount, when these are not guaranteed.

4.14 **If a creditor** takes **expenditure** into account in assessing affordability, such considerations might reasonably take into account regular household expenditure and relatively fixed outgoings (monthly rental payments for example). As in the case of income, such an assessment should be based on what is

known at the time the assessment is undertaken and should take reasonable account, to the extent that it is possible (and proportionate) to do so, of the varying nature of certain items of expenditure over the anticipated repayment period. Caution should be exercised before assuming, for example, that a recent household bill necessarily represents 'the norm' for the entire term of the credit agreement: for example, the cost of an electricity bill in the Summer might be considerably less than the equivalent bill in the Winter.

- 4.15 In our view, creditors who do not require **documentary evidence** of income and/or expenditure as part of their assessment of affordability, but rather accept information provided by the borrower without any supporting evidence or, in the alternative, do not seek **any** information on income and/or expenditure at all as part of their assessment, should ensure that whatever means and sources of information they employ are sufficient to make an appropriate assessment. We do not consider self-certification of income would generally be sufficient in respect of significant long-term credit agreements, particularly those secured on property.

It may be appropriate for the creditor to use affordability calculators which assume a reasonable level of domestic outgoings on day to day expenditure.
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- 4.16 Whilst the OFT accepts, as a general principle from a proportionality perspective, that the level of scrutiny required for small sum and/or short-term credit may be somewhat less than for large sum and/or long-term credit, we consider that creditors should also take account of the fact that the risk of the credit being unsustainable would be directly related to the amount of the credit granted (and associated interest/charges etc.) relative to the borrower's financial situation.
- 4.17 The OFT would normally consider it appropriate for a relatively high level of scrutiny to be undertaken in the case of secured credit whereby homeowners with a first mortgage access further borrowing secured by a second or subsequent charge on their

property. This should also be the case where unsecured debt is consolidated into a secured loan.

Specific irresponsible lending practices

- 4.18 Set out below are examples of practices that the OFT considers may, depending on the exact circumstances, amount to irresponsible lending.

Unsatisfactory business practices and procedures

- 4.19 Failing to establish and implement clear and effective policies and procedures for the reasonable assessment of affordability.
- 4.20 Failing to undertake a reasonable assessment of affordability in an individual case or cases.
- 4.21 Failing to consider sufficient information to be able to reasonably assess affordability, prior to granting credit, significantly increasing the total amount of credit provided, or significantly increasing the credit limit (in the case of a running account credit agreement).

This **could** (but not necessarily) include, for example:

- Failing to take proper account of relevant information contained in databases when these are referenced. Relevant information could include, for example, information on credit reference files such as notices of correction.
- **Where applicable, appropriate and proportionate**, failing to verify details of current income and/or expenditure by, for example, checking hard copies of payslip/contract of employment (when a borrower is in employment), accountant's letters (when a borrower is self-employed) or benefit statements (when a borrower is not in employment).

- 4.22 Failing to undertake an assessment of creditworthiness of a borrower on the basis of sufficient information obtained from the borrower where this is appropriate, and a credit reference agency where this is necessary, before a regulated consumer credit agreement, other than an excluded agreement, is made with the borrower, or the amount of credit provided by the creditor to the borrower is increased significantly, or the credit limit is increased significantly (in respect of an agreement for running account credit), in accordance with the requirements of section 55B of the Act.

The 'assessment of creditworthiness' is a 'creditor-focussed' test which involves the creditor assessing whether a borrower merits the provision of the credit that he is seeking to acquire on the basis of considering sufficient information relating to such matters as the borrower's earning power and previous record of repayment.

There is a legal requirement on creditors, under section 55B of the Act, to undertake an assessment of a borrower's creditworthiness prior to making a regulated consumer credit agreement, or before the amount of credit under a regulated consumer credit agreement is increased significantly, or before the credit limit under a regulated consumer credit agreement for running account credit is increased significantly.

This legal requirement does not apply to a regulated agreement under which the creditor takes any article in pawn or to the provision of credit secured against land which are 'excluded agreements' for the purposes of section 55B(4) of the Act.

- 4.23 Failing to take reasonable steps to assess (on the basis of information that the creditor is aware of at the time the credit is granted) whether a prospective borrower is likely to be able to meet repayments in a sustainable manner.

The actual assessment undertaken should be subject to **proportionality** considerations in each case.

- 4.24 Basing the consideration of affordability primarily or solely on an assessment of the value of any security provided by the applicant.

For example, the value of equity in the property on which the credit is to be secured.

The OFT would be **unlikely** to consider this to be an irresponsible lending practice in the case of pawn-broking where the borrower's liability was limited to the pledged item plus the interest on the credit (and there were no additional charges imposed).

- 4.25 Granting an application for credit in the absence of having undertaken **any** assessment of affordability (see text box above).
- 4.26 Granting an application for credit when, on the basis of an affordability assessment, it is known, or reasonably ought to be suspected, that the credit is likely to be unsustainable.

For example, when it is apparent that the borrower has insufficient disposable income (or alternative means of repayment) to be able to afford to keep up repayments in a sustainable manner.

In the OFT's view, this could include situations where the creditor is aware that the borrower only had sufficient disposable income to be able to make repayments that pay off interest on open-end credit but none of the capital.

A further example could be where a borrower is advised by a creditor to consolidate his existing debts under circumstances in which it is clear from the affordability assessment, or ought to be clear from such an assessment, that this is likely to lead to an unsustainably higher cost of credit in the longer term. In the OFT's view, under such circumstances, the borrower may be better and more appropriately advised to seek assistance in the first instance from a not-for-profit provider of free and impartial money advice.

- 4.27 **Inappropriately encouraging** borrowers to increase, aggregate or roll over existing debt to **unsustainable** levels.

In our view, this does not prevent creditors rescheduling repayments where a borrower is experiencing difficulty - allowing the borrower longer to pay off the debt - provided that this does not increase the total amount payable to unsustainable levels or otherwise impact adversely on the borrower's overall financial situation.

It would also not preclude debts being consolidated under circumstances in which the borrower's overall financial position is not detrimentally affected i.e. the borrower's indebtedness does not become unsustainable or increasingly unsustainable.

- 4.28 Advising or encouraging a borrower to take out a loan for a higher amount than he requests when, on the basis of an assessment of affordability, it is known, or reasonably ought to be suspected, that repayment of the higher credit amount is unsustainable.
- 4.29 Failing to take adequate steps, so far as is reasonable and practicable, to ensure that information on a credit application relevant to an assessment of affordability is complete and correct.

This includes all/any information supplied by the borrower.

- 4.30 Completing all or part of an application for credit, intended to be completed by the borrower, in the absence of prior consent from the borrower to do so on his behalf (unless the borrower is afforded the opportunity to check that the application has been completed accurately - and in accordance with his instruction where applicable - and approve the information prior to signing the credit agreement).
- 4.31 Accepting an application for credit under circumstances in which it is known, or reasonably ought to be suspected, that the borrower has not been truthful in completing the application for credit with regards to the information supplied relevant to inform an assessment of affordability.

For example, when the information supplied in respect of his employment status and/or related income is clearly inconsistent with other available information.

Deceptive and/or unfair practices

- 4.32 Inducing or encouraging a borrower to falsify details relevant to an assessment of affordability on a credit application.
- 4.33 Distorting and/or falsifying details relevant to an assessment of affordability on a credit application, with or without the borrower's consent.

5 PRE-CONTRACTUAL ISSUES

Specific irresponsible lending practices

- 5.1 Set out below are examples of practices that the OFT considers may, depending on the exact circumstances, amount to irresponsible lending.

Unsatisfactory business practices and procedures

- 5.2 Employing the use of advertising,²³ and/or other promotional material, and/or other oral or written representations, which suggest, either expressly or by implication, that credit is available regardless of the borrower's financial circumstances.

Credit may not be described as 'guaranteed', 'pre-approved', or able to be provided without any credit checks being undertaken, unless it is free of any conditions regarding the financial circumstances of the borrower to whom it is to be provided. If a creditor wishes to reserve the right to make further checks on a borrower's financial circumstances, and/or to decline an application if it contains information impacting on affordability/a borrower's ability to repay, such expressions should not be used. For the credit to be genuinely pre-approved, the creditor should have undertaken an appropriate affordability assessment of the borrower **in advance** of offering him the credit.

The OFT considers that 'trading names' (which can include web addresses/domain names) and 'logos' can act as 'promotional material' and that an implication may be contained in a trading name or logo.

²³ The OFT would expect all advertising to comply with relevant statutory requirements and to abide by the CAP and BCAP advertising codes as appropriate.

www.cap.org.uk/The-Codes.aspx

- 5.3 Employing the use of advertising, and/or other promotional material, and/or other oral or written representations, offering credit with pre-completed amounts of credit which are not based on a prior affordability assessment.
- 5.4 Employing the use of advertising, and/or other promotional material, and/or other oral or written representations which suggest, either expressly or by implication, that credit is dependent only upon the value of equity in the property on which it is to be secured.
- 5.5 Promoting the sale of a particular credit product to an individual borrower under circumstances in which the creditor has reason to believe that the product is **clearly** unsuitable for that borrower given his financial circumstances and/or his intended use of the credit (if known).

For example, advising a borrower to take out a secured loan, or to replace or convert an unsecured loan to a secured loan, when it is clearly not in the borrower's best interests to do so at that time. Another example would be promoting a short-term loan product such as a payday loan, which would be expensive as a means of longer term borrowing, as being suitable for supporting sustained borrowing over longer periods.

In the OFT's view, considerations of the 'suitability of intended use' would not cover such matters as whether a borrower should or shouldn't seek credit to, for example, pay for a holiday (as opposed to seeking credit to pay for more obvious 'essentials') – subject to the type of credit being provided not being unsuitable for its intended use²⁴ and an appropriate assessment of affordability being undertaken prior to granting the credit to the borrower.

²⁴ See section 55A(2)(a) of the Act and paragraph 3.13 of this guidance document.

We also consider that differential commission rates or 'volume over-riders'²⁵, should be offered to brokers or other intermediaries marketing the creditor's products only where these are justified in terms of the relative work involved.

We further consider that under appropriate circumstances²⁶, the **existence** of any commission or other payment payable by the creditor, and of any other reward available from the creditor, in respect of the relevant credit agreement, should be disclosed by the broker or intermediary to the borrower before the credit agreement is made, whether or not the borrower has requested this information.

The **amount or likely amount** of any commission should be disclosed by the broker or intermediary, before the credit agreement is made, **on request by the borrower**, in order that the borrower should be enabled to take a view as to whether there is likely to be any conflict of interest.

²⁵ Volume over-riders are additional payments made on the basis of business volume and profitability.

²⁶ In the OFT's view, the **existence** of any 'commission' payable to a broker or intermediary by a creditor in respect of the relevant credit agreement should be made known to a potential borrower by the broker or intermediary under circumstances in which the existence/amount of the commission **could** actually or potentially act as an undue incentive for the broker or intermediary to recommend a particular credit product (as opposed to an appropriate alternative, from the borrower's perspective, from the product range available the broker/intermediary) to a potential borrower and/or where knowledge of the existence/amount of the commission **could** actually or potentially have a material impact on the potential borrower's borrowing decision. In effect, potential borrowers should be made aware of the **existence** of a financial arrangement between a broker or intermediary with a creditor which might potentially impact upon the **impartiality** of the broker or intermediary in terms of the credit product(s) that it promotes to a potential borrower.

- 5.6 Providing credit to a borrower in the absence of having assessed the mental capacity²⁷ of the borrower, under circumstances in which it is known he may lack - or it is reasonably believed that he may lack - the capacity to comprehend the information and/or explanations provided by the creditor to inform his borrowing decision at the time the information and explanations are provided.

To be considered as lacking capacity in relation to a particular decision, a person must have some form of impairment of - or disturbance in - the functioning of the mind or the brain which results in an inability to make the specific decision at that time. Capacity should always be judged in relation to a specific decision. In order to demonstrate decision making capacity, a borrower should be able to understand the information relevant to the decision, including the purpose of any proposed course of action, the main benefits, risks and alternatives.

In law, a person is assumed to have capacity unless/until it is established that he lacks capacity and he should not be treated as unable to make a decision unless all practicable steps to help him do so are taken without success. A person should also not be treated as being unable to make a decision solely on the basis that he might make a bad decision.

²⁷ With regards to paragraph 5.6, please refer to the provisions and explanatory notes of the Mental Capacity Act 2005 (covering England and Wales)

www.opsi.gov.uk/acts/acts2005/ukpga_20050009_en_1

and the associated Mental Capacity Act 2005 Code of Practice to which the OFT would expect creditors to have particular regard.

www.dca.gov.uk/menincap/legis.htm#codeofpractice

For the situation in Scotland, please refer to the Adults with Incapacity (Scotland) Act 2000.

www.scotland.gov.uk/Publications/2007/08/29112925/0

However, as stated in the Mental Capacity Act 2005 Code of Practice, it is important to balance a person's right to make a decision with their right to safety and protection when they can't make decisions to protect themselves. See Annex 4 to this guidance document for further information.

- 5.7 Failing to allow the borrower to withdraw from a prospective or signed credit agreement within the cooling off period, if one is provided for either by legislation or under contract, or placing undue obstacles in the way of him doing so.

Transparency

- 5.8 Employing the use of advertising, and/or other promotional material, and/or other oral or written representations, which understate, mask, or omit material information regarding the key risks to the borrower.

Physical/psychological harassment

- 5.9 Failing to observe the consideration period in the case of secured loans in accordance with the requirements of sections 58 and 61(2) of the Act.
- 5.10 **Inappropriately** encouraging, inducing or incentivising a borrower to sign up to an agreement quickly, without allowing the borrower time to consider pre-contract information and explanations.

The OFT would not consider stating an 'end date' for a promotional offer to, in itself, constitute an irresponsible lending practice.

- 5.11 **Inappropriately** encouraging, inducing or incentivising a borrower to take out a loan for a higher amount than the borrower requests.

The OFT would not consider that simply 'offering' a borrower more credit than he requests to be an irresponsible lending practice per se provided that:

- the offer of the higher amount was based on a proper assessment of affordability and
- the borrower was not pressurised or inappropriately coerced into accepting the higher offer.

The OFT would not consider a creditor offering 'tiered loan pricing' for different loans or offering a borrower some form of 'legitimate benefit' if he accepts an offer of more credit, to, in itself, constitute 'inappropriate coercion', provided that any such offers are sufficiently transparent and subject to the undertaking- and outcome- of a proper affordability assessment by the creditor.

Deceptive and/or unfair practices

- 5.12 Employing the use of advertising, and/or other promotional material, and/or other oral or written representations which either present or omit key information relevant to a borrowing decision such as to actually or potentially create a false or misleading impression to potential borrowers.
- 5.13 Misleading a potential borrower into believing that his current debt repayments could be reduced over the same term when this is not in fact the case.

For example, stating a monthly repayment figure without also stating the duration of the payment period and the total amount payable where these may be higher than under existing arrangements.

- 5.14 Falsifying a borrower's signature on a credit agreement.

6 CONTRACTUAL AND POST-CONTRACTUAL ISSUES

Specific irresponsible lending practices

- 6.1 Set out below are examples of practices that the OFT considers may, depending on the exact circumstances, amount to irresponsible lending.

Unsatisfactory business practices and procedures

- 6.2 Failing to monitor a borrower's repayment record.²⁸

The OFT considers that creditors should take appropriate action, including notifying the borrower of the potential risk of an escalating debt, and signposting the borrower to not-for-profit providers of free independent debt advice, when/if there are signs of apparent/possible repayment difficulties – for example, a borrower failing to make minimum required payments or making a number of consecutive small/minimum repayments or a borrower seeking to make repayments on a credit card account using another credit card. This is particularly important in the case of borrowers who it is known - or it is reasonably believed - may lack the mental capacity to make financial decisions about repayments at the time the repayments are due, especially under circumstances in which the borrower or his representatives have specifically requested that this should be done.

A symptom of some conditions such as bipolar disorder is that the borrower may engage in unusual spending patterns.

- 6.3 Failing to allocate repayments against an outstanding credit card or store card balance to the highest rate debt first.

Borrower's monthly payments should always pay off their most expensive card debt first.

²⁸ See also Chapter 7.

Allocating payments to the most expensive balances first should apply to all revolving amounts on a credit or store card. Where such an agreement includes a fixed-sum credit plan agreement (for example an installment loan on a store card under which the consumer undertakes to pay regular fixed installments over a certain period) this allocation method should be applied to payments beyond those required to satisfy the fixed installments.

- 6.4 **Setting the minimum repayment on a credit card or store card agreement at a level that does not cover at least 1 per cent of the principal (as per the balance) plus interest, fees and charges that have been applied to the account.**²⁹

Where a card lender applies interest for a period which covers more than one month (for example, in the case of a buy now, pay later agreement, or where interest is backdated on the expiry of a balance transfer deal), the level of the interest component within the minimum payment for any month should be proportionate to the period over which the lender accrues the interest.

- 6.5 Failing to provide borrowers under credit card and store card agreements with the option to pay any amount they choose (equal to, or more than, the minimum repayment, but less than the full outstanding balance) on a regular basis when making automated repayments.
- 6.6 Increasing, or offering to increase, a credit card or store card customer's limit under circumstances in which the card holder has advised that he does not want any limit increases.
- 6.7 Increasing- or offering to increase- the limit of a credit card or store card customer who is **at risk of financial difficulties**.

²⁹ Applies to **new** credit card agreements and is effective as of 1 April 2011 (aligned with the incorporation of this requirement into the Lending Code).

We would expect card companies to work with debt advice agencies to agree how borrowers 'at risk' should be identified.

- 6.8 Failing to reduce a borrower's credit card or store card limit following receipt of a request (given at any time) from the borrower to do so.

Card customers wishing to reduce their credit limits or decline offers of increased credit limits should be able to do so at any time, without being directly 'penalised' by the creditor for doing so and/or it should not be in any way implied by creditors that borrowers may be directly penalised by them for doing so. However, borrowers should be aware that reducing the limit may, for example, indirectly impact on their credit ratings.

- 6.9 Failing to provide borrowers with the option to decline receipt of credit limit increases (as applied to a credit card or store card agreement) or to reduce their limits at any time either online or via automated telephone system.

The option of being able to decline credit limit increases or reduce limits online or via an automated telephone system should reassure those borrowers who seek such reassurance that the card company will not be able to dissuade them from doing so or be able to offer them alternative products.

- 6.10 Increasing the interest rate of a credit card or store card customer who is **at risk of financial difficulties**.

Under the Statement of Fair Principles established at the 'Credit Card Summit' in December 2008, relevant creditors committed not to increase interest rates for borrowers who have fallen behind on payments and/or those who have already agreed a repayment plan for the account or are in serious discussion with a debt advice agency regarding a debt repayment plan.

- 6.11 Failing to give a credit card or store card customer 60 days to reject an interest rate increase, **after** he is first notified of the change, by closing down his account and paying down the outstanding balance at the existing rate over a reasonable period.

These considerations should apply to any interest rate increases which are not directly linked to a change in an external reference rate such as the base rate or the London Interbank Offered Rate (LIBOR) and not just to individual risk-based re-pricing.

We would expect card companies, under such circumstances, to **consider** offering borrowers an alternative product (if there is one available) at an equivalent or lower rate of interest. This approach is incorporated in the Lending Code in respect of certain types of credit cards (i.e. those where risk-based pricing has been used).

Transparency

- 6.12 Failing to provide borrowers with clear information on their rights under the agreement, including how to complain if things go wrong.³⁰

Rules that set out in detail how businesses should handle complaints are published in the FSA's Handbook. These rules apply to all businesses that are or have been regulated by the FSA or the OFT.³¹

The rules largely reflect common sense and good business practice. In simple terms, they require consumer credit licence holders to have effective and clear procedures for dealing with any complaints fairly and reasonably.

³⁰ For more information see the Financial Ombudsman Service website:-

www.financial-ombudsman.org.uk

www.financial-ombudsman.org.uk/publications/technical_notes/QG6.pdf

www.financial-ombudsman.org.uk/publications/pdf/guide_complaints_handlers.pdf

³¹ Section 226A of the Financial Services and Markets Act 2000 provides that a complaint, relating to an act or omission of a licensed consumer credit businesses (amongst others), qualifies to be dealt with by the Financial Ombudsman Service, if certain conditions are satisfied.

Businesses' complaints procedures must take into account, amongst other matters, the time limits for dealing with complaints and the borrower's ultimate right to refer any unresolved dispute to the Financial Ombudsman Service.

- 6.13 Where applicable, failing to keep the borrower adequately informed of the state of his account via the provision of regular statements, in accordance with the requirements of section 77A or 78(4) of the Act.

There are separate rules in relation to overdrafts.

- 6.14 Failing to provide to the borrower, on request, a clear and transparent settlement statement in accordance with section 97 of the Act, setting out the amount required to settle the agreement early (or a statement in accordance with section 97A regarding the effect of a partial repayment).

This requirement does not apply to a request made less than one month after a previous such request relating to the same agreement was complied with by the creditor.

The OFT considers that the basis on which any settlement figure has been calculated should be explained to the borrower upon receipt of a request to do so.

- 6.15 Failing to provide borrowers with sufficient notification, in the form of clear, written, information, regarding any variations in the terms and conditions of the agreement which may adversely impact on the borrower, prior to any such variation coming into effect. This would include any increase in the interest rate or charges under the agreement. Notice should be given in accordance with section 78A or section 82(1) of the Act as applicable.

The OFT would consider 'prior' in this context to constitute sufficient time for the borrower to take necessary remedial action as a consequence of the proposed variation including withdrawing from the agreement prior to the variation coming into effect if he so wishes.

Although not a statutory requirement, we would encourage creditors to consider notifying a borrower that a preferential rate of interest is about to end in order to provide him with the opportunity to settle the outstanding debt.

- 6.16 Failing to send a minimum payments warning communication to a borrower under a credit card or store card agreement who is using his card in ways which may be putting him at risk of financial difficulties or incurring high levels of interest on his debts.

For example, such communications could be sent when a credit card or store card customer is making repeated low repayments or failing to make any repayment.

- 6.17 Failing to notify a credit card or store card customer at least 30 days **prior** to a limit increase coming into effect.
- 6.18 Failing to notify a credit card or store card customer at least 30 days **prior** to an interest rate increase on his card coming into effect.
- 6.19 Failing to notify a credit card or store card customer of his right to reject (within a period of 60 days) an increase in the interest rate applied to his credit card account and pay down the card at its existing rate (and how to do so) at least 30 days before a proposed interest rate increase by the credit card company.

Deceptive and/or unfair practices

- 6.20 Varying interest rates where there is no valid reason for doing so.

For example, in our view, variable rates should not be misused to take advantage of a borrower's lack of ability to end the agreement, or restrictions on him doing so such as redemption charges.

'Valid reasons' may include:

- the recovery of genuine increased costs in lender funding or
- a change in the risk presented by a borrower such as to justify a change in the interest rate.

Schedule 2 to the Unfair Terms in Consumer Contracts Regulations 1999 (Statutory Instrument 1999 No.2083) identifies the following terms which may be regarded as unfair:

Terms which may have the object or effect of:

Paragraph 1(j) – enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract

Paragraph 1(l) – providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded.

We consider that it would be appropriate for a borrower to be given an explanation that applies to his individual circumstances when his rate has been increased on the basis of a 'risk assessment', in order that he might better understand what steps he can take to positively affect his own credit rating.

In the OFT's view, it could be disproportionate to increase the interest rate applied to a borrower solely on the basis that the borrower had, for example, missed a single repayment or had failed to pay in full on one or two occasions.

6.21 Providing unsolicited credit card cheques to a borrower.

- 6.22 Providing unsolicited credit tokens in contravention of section 51 of the Act.
- 6.23 Setting charges for early repayment at a level that does not accord with relevant statutory requirements.

Settlement charges should be calculated in accordance with the Consumer Credit (Early Settlement) Regulations 2004, as amended by the Consumer Credit (EU Directive) Regulations 2010, where applicable. The Regulations stipulate the minimum rebate that must be given to the borrower upon early settlement (in whole or in part) of a regulated agreement and the circumstances in which a compensatory amount may be charged in accordance with section 95A of the Act.

- 6.24 Refinancing a borrower's existing credit arrangements, without the borrower's request or consent to do so or where it is **clearly** against the best interests of the borrower to do so.
- 6.25 Repeatedly refinancing (or 'rolling over') a borrower's existing credit commitment for a short-term credit product in a way that is **unsustainable**³² or otherwise harmful.

The OFT considers that this would include a creditor allowing a borrower to sequentially enter into a number of separate agreements for short-term loan products, one after another, where the overall effect is to increase the borrower's indebtedness in an unsustainable manner.

The general purpose of short-term loans, such as 'payday loans', is to provide borrowers with a cash advance until their next pay day and they are usually about 30 days, or just over, in duration. However, in certain circumstances, the borrower can elect to 'renew' the loan for a fee and delay payment for a further agreed period of time.

³² See paragraphs 4.2 to 4.8 inclusive

The purpose of payday loans is to act as a short-term solution to temporary cash flow problems experienced by consumers. They are not appropriate for supporting sustained borrowing over longer periods, for which other products are likely to be more suitable.

- 6.26 Failing to lower a borrower's credit limit following receipt of a specific request to do so by the borrower.
- 6.27 Providing a borrower with a new or additional source of credit following receipt of a specific request from the borrower not to do so.

This would include failing to remove any such facility following receipt of a specific request from the borrower to do so.

- 6.28 Failing to allow the borrower to repay part of the capital under a regulated consumer credit agreement at any time, in accordance with section 94(3) of the Act.³³

Any charges applied on such partial early repayment should be set in accordance with sections 95 and 95A of the Act.

³³ This right does not apply to agreements secured on land.

7 HANDLING OF DEFAULT AND ARREARS

Specific irresponsible lending practices

- 7.1 Set out below are examples of practices that the OFT considers may, depending on the exact circumstances, amount to irresponsible lending.

Unsatisfactory business practices and procedures

- 7.2 Failing to establish and implement clear, effective, and appropriate, policies and procedures for dealing with borrowers whose accounts fall into arrears.

In our view, these policies and procedures should make specific provision for, amongst other matters, the fair and appropriate treatment of vulnerable borrowers such as those known to- or reasonably believed to- lack the mental capacity to make relevant financial decisions at a particular time.

- 7.3 Failing to treat borrowers in default or arrears difficulties with understanding and due consideration.

For example, a lack of mental capacity to make a relevant financial decision at any particular time may impair a borrower's ability to maintain repayment schedules. Borrowers lacking mental capacity to make such decisions at any particular time may be unable to engage with debt repayment at that time and consequently it would not be appropriate to regard - or treat - them as 'uncooperative' or 'won't pay'. We consider that 'reasonable adjustments' should be made to policies and procedures for recovering debts, to the extent that it is appropriate or necessary to do so, under circumstances in which borrowers are known to- or reasonably believed to- lack the mental capacity to make the requisite financial decisions at the time at which they are being pursued for the debt.

In our view, creditors' policies and procedures for the appropriate treatment of borrowers who lack the mental capacity to make the requisite financial decisions, at a time at which they are experiencing problem over-indebtedness and are being pursued for a debt, might appropriately have regard to the **principles** outlined in the Money Advice Liaison Group (MALG) Guidelines 'Debt Management and Debt Collection in Relation to People with Mental Health Problems'.³⁴ While it is the case that mental health problems/disorders are by no means the same as a lack of mental capacity (a borrower could have a mental health problem but still have the capacity to make relevant financial decisions), we consider that there is a degree of general applicability of the MALG Guidelines in terms of the treatment of vulnerable borrowers.

7.4 Failing to treat borrowers in default or arrears difficulties with forbearance.

The OFT would encourage creditors to **consider** suspending any further interest and charges and/or allowing deferment of payment of arrears under circumstances in which a requirement for immediate payment of arrears may either increase the borrower's repayments to an unsustainable level or otherwise necessitate the repayment period for the borrower being substantively extended such that it becomes unreasonably excessive.³⁵

In the OFT's view, creditors should **consider** reducing or stopping interest and charges when a borrower evidences that he is in financial difficulty and is unable to meet repayments as they fall due or when he can only make 'token' repayments such that his level of debt would continue to increase if interest and charges continued to be applied.

³⁴ www.moneyadvicetrust.org/download.asp

³⁵ See paragraph 4.6 of this guidance document.

We would also encourage creditors to accept token payments from borrowers with deficit budgets (i.e. they owe more than they need to spend on basic living expenses) to allow the borrower a reasonable period of time to recover from an unexpected income shock.³⁶

Transparency

- 7.5 Failing to inform the borrower when he has gone into arrears (as set out in sections 86B or 86C of the Act) or failing to comply with relevant statutory requirements regarding arrears notices or default notices.

In the OFT's view, where statements and notices are required to be sent to borrowers who are in an Individual Voluntary Arrangement (IVA) or bankruptcy, the creditor should consider including a covering letter (or similar communication) explaining the situation, to minimise the risk of confusion or distress on the part of the recipient.

- 7.6 Failing to provide borrowers with OFT information sheets on arrears or default where triggered.
- 7.7 Failing to inform the borrower of the imposition of any default sum, or any increase in interest or charges, in accordance with statutory requirements, where applicable.
- 7.8 Failing to provide notice to a borrower that responsibility for recovery of a debt and/or the legal right to recover a debt has been transferred or assigned to a (named) third party.

The OFT considers that such notification should be provided at the point in time when the **true** debtor's location has been established.

³⁶ www.justice.gov.uk/news/newsrelease150310a.htm

The responsibility for arranging for notice to be given falls on the assignee under section 82A of the Act - although the assignee may arrange for notice to be given by the assignor.

The OFT does not consider that the creditor should be held accountable in respect of 7.6 to 7.8 (above) under circumstances in which the borrower has 'gone away' without notifying the creditor of his change of address and it would be impracticable for the creditor to establish the borrower's current whereabouts.

- 7.9 Failing to act in accordance with the principles outlined in the pre-action protocols practice direction in the Civil Procedure Rules when considering instituting court proceedings against a borrower.³⁷

The objectives of pre-action protocols are to encourage the exchange of early and full information about the prospective legal claim, to enable parties to avoid litigation by agreeing a settlement of claim before the commencement of legal proceedings and to support the efficient management of proceedings where litigation cannot be avoided. The OFT considers it particularly important that creditors fully observe the rights of borrowers in respect of 'possession claims'.

In the OFT's view, it would not be appropriate for creditors to initiate court proceedings where it is known or understood that the borrower has submitted a reasonable complaint relating to the credit agreement that is being considered by the Financial Ombudsman Service.

Physical/psychological harassment

- 7.10 Making undue, excessive or otherwise inappropriate use of statutory demands when a borrower falls into arrears.

³⁷ www.justice.gov.uk/civil/procrules_fin/contents/practice_directions/pd_protocol.htm

- 7.11 Failing to suspend the pursuit of recovery of a debt from a borrower in default or arrears difficulties under circumstances in which the borrower disputes the debt and has- or appears as if he may have- valid grounds for doing so.

The OFT would consider valid grounds for disputing a debt arising when the individual being pursued for the debt is not the debtor in question (or the guarantor of the debt in question), or that the debt does not exist, or is statute barred, or the amount of the debt is incorrect.

Under such circumstances, the onus should be on the business seeking to recover the debt to establish that the person being pursued is the person who owes the debt (and that it is for the amount stated), not on the individual to establish that he is not the debtor.

The OFT also considers that creditors have a responsibility for endeavouring to ensure that base data that they pass to debt collectors or sell on to debt purchase businesses, for the purposes of pursuing debt recovery, is accurate such as to facilitate the tracing and identification of the true debtor.

We further consider that all debt recovery businesses have a responsibility to check the accuracy of such data supplied by their clients or obtained from credit reference agencies.

- 7.12 Failing to suspend the active pursuit of recovery of a debt from a borrower in default or arrears difficulties for a reasonable period under circumstances in which it can be evidenced that a debt advisor is assisting the borrower in agreeing a repayment plan.

The Credit Services Association committed to Government in 2009 that its members would not contact debtors to pursue debts for 30 days, as soon as they have been informed that a debt advisor has taken on the case on behalf of the borrower, with a view to allowing the debt advisor to negotiate with creditors and/or any third party debt recovery businesses so that a plan for repaying the debt can be agreed.

A similar commitment to provide borrowers with 'breathing space' was provided by relevant creditors at the Credit Card Summit in December 2008.

Similar breathing space should be extended to a borrower where it can be evidenced that he is developing a plan on his own account for repaying the debt i.e. without the assistance of a debt advisor.

- 7.13 Failing to suspend the pursuit of recovery of a debt from a borrower, under circumstances in which notification has been given - and/or it is reasonably believed - that the borrower lacks the mental capacity to make relevant financial decisions regarding the management of his debt at that time, unless or until a reasonable period of time has been allowed for relevant evidence to be provided as to the likely impact of the capacity problem on the borrower's ability to manage his debt and deal with a debt recovery business.

The OFT considers that one appropriate means of collecting evidence, in appropriate circumstances, could be to use the standard Debt and Mental Health Evidence Form (DMHEF)³⁸, developed between MALG and the Royal College of Psychiatrists. The DMHEF is designed to assist financial advisors and creditors in requesting relevant and proportionate information from health/social care practitioners.

In the previously mentioned MALG Guidelines, it is suggested that 28 days is a reasonable length of time to allow for the gathering of relevant evidence. In our view, further negotiation would be reasonable under circumstances in which it is made clear to the creditor that unavoidable delays in collecting such evidence have occurred (although all reasonable steps should be taken to keep such delays to a minimum).

³⁸ www.moneyadvicetrust.org/section.asp?cid=53

It should be noted that the DMHEF form is not necessarily a suitable means for gathering evidence on the effects of a person's autism on their ability to meet repayments.

The OFT considers that it would be appropriate for a debt recovery business to **at least** delay pursuance of a debt under circumstances in which it is established that a borrower lacks the capacity to make relevant financial decisions at that time, until the borrower regains capacity, or to only pursue the debt via a responsible third party, acting on behalf of the borrower and with the borrower's prior consent – for example, a person managing the borrower's affairs pursuant to a Lasting Power of Attorney or an order of the Court of Protection.³⁹

In the OFT's view, creditors should **consider** writing off debts where a borrower lacked the mental capacity to make the relevant financial decision at the time that he entered the credit agreement with the creditor. The legal position in England and Wales is that a contract is voidable where the creditor knew of the incapacity or must be taken to have known of it. In Scotland, debts can be written off where there is incapacity regardless of whether the creditor was given notice of the incapacity or not (in line with common law on contract in Scotland - where a party to the contract lacks legal capacity, the contract is void – although this would be potentially subject to legal challenge based on the facts in individual cases).

Proportionality

7.14 Taking steps to repossess the borrower's home, other than as a last resort.

The OFT would not expect a creditor to take disproportionate action against borrowers in respect of arrears or default. This would include such matters as applying to the court for an order for sale or for the borrower to be made bankrupt, without having explored other alternative, more proportionate options for recouping arrears.

³⁹ Lasting Powers of Attorney do not exist in Northern Ireland. An enduring power of attorney can be granted and must be lodged in the High Court through the Office of Care and Protection.

In the OFT's view, it would not be disproportionate for creditors to apply for charging orders (or inhibitions in Scotland) against a borrower's home as a means of securing arrears owed to them. However, we would consider it to be an unfair and irresponsible lending practice for creditors to use the **threat** of court action followed by a charging order (or inhibition) to intimidate borrowers in financial difficulties to pay more than they could reasonably afford.

We consider that other possible options for dealing with the problem should be explored prior to resorting to taking steps to repossess the borrower's property and that proper consideration should be given to any reasonable offer by the borrower to pay by instalments.

The OFT would further expect second charge lenders in England and Wales to have regard to the requirements of the Pre-action Protocol for Possession Claims Based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property (PAP) as set out by the Civil Justice Council in October 2008⁴⁰. The aims of the PAP are to ensure that a lender and a borrower act fairly and reasonably with each other in resolving any matter concerning arrears, and to encourage more pre-action contact in an effort to seek agreement between the parties on alternatives to repossession.

The Pre-action Protocol on Possession Proceedings applies to all mortgage repossession cases in Northern Ireland.⁴¹ The Home Owner and Debtor Protection (Scotland) Act 2010 provides for pre-action requirements to be placed on secured lenders in Scotland.

⁴⁰ www.civiljusticecouncil.gov.uk/files/Mortgage_Pre-Action_protocol_21_Oct.pdf

⁴¹ www.courtsni.gov.uk/NR/rdonlyres/AD58FDA3-0D76-4723-B067-6DB0F673E3FE/O/p_pc_Repossession_of_Mortgages_Protocol.pdf

Deceptive and/or unfair practices

7.15 Imposing unreasonable charges on borrowers in default or arrears.

In the OFT's view, any default or other charges should be transparent and limited to what is reasonable, doing no more than covering the creditor's reasonable costs.

7.16 Failing to allow for alternative, affordable, payment amounts when a reasonable proposal is made by the borrower or his appointed debt advisor or representative.

The OFT would expect creditors to respond to borrowers and/or their appointed representatives regarding such proposals in a timely manner (an exception to this could be where multiple proposals are submitted in a short period).

Under circumstances in which creditors reject any such proposal, we consider that they should provide the borrower and/or his appointed representative with a clear explanation of the basis for rejecting the proposal.

We further consider that creditors should allow borrowers or their appointed representatives a reasonable period of time to consider and respond to any counter-proposal for a repayment plan subsequently made by the creditor.

In the OFT's view, those seeking to recover debts should have regard to the principles (or equivalent) incorporated in the Common Financial Statement in communications with third party money/debt advisors who propose repayment plans on behalf of borrowers.⁴²

7.17 Taking steps to enforce a debt against a borrower who is subject to a debt relief order (DRO).

⁴² www.moneyadvicetrust.org/images/CFS_creditor.pdf

This would not apply to creditors whose debts cannot be scheduled in the DRO or to those creditors whose debts are included in the DRO but who have successfully obtained leave from the court to pursue their debts.

- 7.18 **Requiring unreasonably** that all arrears are paid in one payment, or in unduly large amounts, and/or within an unreasonably short period.

This would not be considered an unfair practice where statute specifically allows for all arrears to be payable in a single payment.

- 7.19 Exercising a right of 'set off' without undertaking an associated affordability assessment or under circumstances in which such an assessment has been undertaken and it is clearly apparent that the borrower is already experiencing an unsustainable level of indebtedness or would be if a right of set off is exercised.

The 'Right of Set Off' is the process whereby banks exercise their common law right to apply a customer's credit balance in one account against unpaid or overdue amounts on other accounts in that customer's name. For example, this could be where a bank takes funds from a customer's current account to cover a missed credit card payment.

The Lending Code (monitored and enforced by the Lending Standards Board) sets minimum standards of good practice that banks, building societies and credit card providers should follow when dealing with retail customers. The OFT agrees with the position as stated in the guidance issued by the Lending Standards Board⁴³ that before applying set-off, businesses should take account of information that they have available to them to identify whether the borrower may be in- or may be heading towards- financial difficulties.

⁴³ Guidance issued in February 2010.

In all cases where set-off is to be applied and it has been established, by the creditor, that the borrower is in financial difficulties, the customer should be left with sufficient money to meet their reasonable day-to-day living expenses and priority debts, where these have been identified. Particular care should be taken where it can be identified that a borrower's balance is made up wholly or in part of state benefits.

8 REGULATORY COMPLIANCE

Evidence of compliance

- 8.1 The OFT expects creditors to take reasonable steps to ensure that they have suitable business practices and procedures in place to facilitate their own compliance (for example through training, auditing, disciplinary policies/procedures, or any other means necessary and appropriate to the business) and to facilitate - and monitor compliance by - their staff, agents and associates, implementing any changes as necessary.
- 8.2 The OFT may use its information gathering powers in order to seek evidence that businesses are following this guidance in appropriate cases. In addition to its power to require information generally under section 36B of the Act, in accordance with section 36C of the Act, the OFT may, by notice to a licensee, require him to facilitate access to his business premises by an officer of the OFT or a local authority trading standards officer, in order to allow him to observe the carrying on of the licensed business or to inspect documents of the licensee which are specified or described in the notice.
- 8.3 It may be incumbent on creditors to provide such documents or information as the OFT requests relating to the practices and procedures that they employ in connection with their regulated consumer credit business (for example where the OFT requests documents pursuant to sections 36B or 36C of the Act) to enable the OFT to form a view as to whether the practices and procedures that they employ are effective. Amongst the matters that the OFT is likely to wish to consider are whether the creditor's practices and procedures:
 - ensure adequate explanations of credit products are provided in accordance with the requirements of section 55A of the Act

- are appropriate to assess a prospective borrower's ability to be able to afford to meet repayments over the life of a credit agreement in a sustainable manner
- deal appropriately with borrowers whose accounts have fallen into arrears
- have been implemented in practice and are effective

In considering 'effectiveness', the OFT may, for example, request data on the number of credit agreements that have resulted in arrears/defaults within a specified period.

- are monitored to assess their ongoing effectiveness and
- have been appropriately amended on the basis of the results of such monitoring as and when appropriate to do so.

8.4 Policies, practices and procedures should be documented and capable of being made available for the consideration of the OFT and/or the relevant Local Authority Trading Standards Service. They should contain sufficient detail in respect of the actual procedures employed to allow the OFT to be able to form a view as to whether the procedures appear appropriate. Creditors may be asked to provide a record of the checks they undertake to assess whether, in practice, they are giving effect to their documented practices and procedures.

A document outlining the business' policies and procedures for assessing affordability, for example, which simply stated that 'appropriate means are employed to assess affordability and ability to repay', or words of similar effect, would not be considered to contain sufficient detail in the absence of more information on the specific means employed.

8.5 Similar assessments may be made of applicants for consumer credit licences.

ANNEXE 1 – CREDITOR'S RESPONSIBILITY FOR CONDUCT OF AGENTS AND THIRD PARTIES

The OFT considers that creditors should take **appropriate** responsibility for acts or omissions of brokers, debt recovery businesses (DRBs) and other intermediaries or agents involved in the lending process. A broker may be a business associate and/or agent of a creditor if the broker is tied to the creditor, or has an ongoing relationship with the creditor, or frequently does business with the creditor. This will be a matter of fact and degree. Similarly, the OFT considers third party debt collection businesses that recover debts on behalf of creditors may be business associates and/or agents of the creditors on whose behalf they act. DRBs to whom creditors have assigned debts may themselves become the 'creditor' under the agreement.

It is not for the OFT to specify in this guidance how creditors' choices about third party selection are made nor to advise on desired conduct between creditors and third parties. However, the OFT would expect creditors to take reasonable steps to satisfy themselves that such persons are not engaging in unfair business practices or acting unlawfully and to take care in selecting third parties with whom to form business associations (complaints about any such third parties to be considered by creditors and action to be taken by creditors in respect of any such complaints as appropriate). If a creditor chooses to do business and/or continues to do business with a third party which it suspects, or reasonably ought to suspect, is engaged in behaviour which the OFT is likely to consider to be inconsistent with fitness to hold a licence, its own fitness may be called into consideration. We would consider licensed businesses simply ignoring the unfair practices of those acting on their behalf - whether in-house or external – to be inconsistent with fitness to hold a consumer credit licence.

ANNEXE 2 - MENTAL CAPACITY

The law relating to mental capacity differs across the UK. In England and Wales, the Mental Capacity Act 2005 applies while in Scotland, the relevant legislation is the Adults with Incapacity (Scotland) Act 2000 (Northern Ireland does not have specific legislation relating to mental capacity and common law applies). Creditors should take responsibility for familiarising themselves with the relevant legislation.

Creditors should always **begin** by assuming that the borrower does have the mental capacity to make the relevant financial decision. Having a mental health problem, or acting in an unusual or unorthodox manner, does not necessarily mean that the borrower lacks the mental capacity to make the relevant financial decision.

The creditor should also employ the use of practices and procedures designed to optimise the likelihood that the borrower will be enabled to make the relevant financial decision. This would include, for example, allowing the borrower the time he requires to make the decision and/or repeating the explanation of the key features of the credit agreement.

If the creditor believes that the borrower does not have the mental capacity to make the relevant financial decision, he should:

- (a) consider whether an impairment of the mind or brain exists (England) or mental disorder (Scotland), and if so
- (b) seek to ascertain whether the impairment or disturbance means the borrower is unable to make the relevant financial decision.

To achieve (b), the creditor would need to assess

- whether the borrower understands the financial decision he is making
- the possible consequences (if any) of that decision
- whether the borrower is able to retain, weigh up and use the information and explanation provided to help enable him to make that financial

decision and

- whether the borrower is able to communicate that decision.

If the creditor is unable to assess (a) or (b), then it should consider seeking specialist support.

If it appears that the borrower does not have the mental capacity to make the relevant financial decision, the creditor can consider:

- delaying the decision (until the borrower regains the mental capacity to make the relevant financial decision)
- following its own (appropriate) practices and procedures (such as contacting an internal specialist)
- checking whether a third-party has the authority to act for and on behalf of the borrower in respect of the financial decision in question or
- contact the appropriate external organisation for assistance or advice (Public Guardian Office in England and Wales, Office of the Public Guardian in Scotland, or Office of Care and Protection in Northern Ireland).