Annexe B – Price controls

Evidence and arguments surrounding price control and interest rate caps for high-cost credit

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1 OUTLINE AND INTRODUCTION

1.1 This annexe outlines the main arguments both for and against the adoption of price controls or interest rate caps¹ that appeared in the literature and in submissions sent to the OFT in connection with our review of high-cost credit. The arguments are grouped into a number of different themes, explored in separate chapters which follow:

- protection from usury and exploitation
- the Usefulness of APR as a measure
- the true cost of lending
- legitimising payday lending
- protecting the public interest
- competition and regulatory intervention
- unintended consequences of capping
- circumvention and enforcement of interest rate caps
- generalising about interest rate caps
- practical matters
- evidence base for Government Policy
- interface with other remedies.

1.2 While a great deal has been - and continues to be - written about interest rate caps as a measure for controlling high prices in credit markets, what changes relatively little are the key themes and arguments, which this

¹ The terms price control, interest rate cap and ceiling are used interchangeably in this document. The majority of references are to caps on interest rates as a form of price control.
annexe seeks to reflect. On the one hand, it is argued that, depending on the rationale of the specific cap, caps can: protect people from usury and exploitation; facilitate the prosecution of exploitative and deceptive lenders; address sources of market failure in the high cost consumer credit sector, including behavioural mistakes that consumers can make; protect the public interest by (for example) limiting the negative externalities of the sector and work as a redistributive mechanism by ensuring a fair and reasonable price for credit transactions. It is also argued that current UK Government policy which has rejected the adoption of a cap in the consumer credit sector\(^2\) is based on flawed evidence and needs to be re-evaluated.

1.3 On the other hand, it is argued that caps would not achieve their specified objectives but would produce a range of unintended consequences instead, including: reducing access to credit and increasing financial exclusion and exploitation of low-income consumers; inadvertently obstructing a range of legitimate and harmless credit transactions; reducing the transparency of credit products as lenders seek ways of evading the cap; distorting the market and reducing product diversity and competition, and causing prices to gravitate up towards the ceiling. It is also argued that caps are difficult to enforce and waste regulatory resources, that they reflect a patronising attitude that the state knows what is best for low-income consumers and that – conversely, for some opponents of caps - they legitimise what should be criminalised and abolished.

The OFT’s review

1.4 During our review of high-cost credit, we received and analysed a large amount of information on the adoption of interest rate caps as a mechanism for protecting consumers. This note outlines the main arguments both for and against the adoption of caps that appeared in the literature and in submissions sent to the OFT.

\(^2\) With the exception of the interest rates charged by Credit Unions, which are limited to 26.8 per cent APR, or two per cent per month.
1.5 The question of whether to adopt interest rate caps on high-cost credit products in the UK attracts strong feelings from both proponents and opponents of caps. As the authors of a 2008 report on overindebtedness for the European Commission comment:

'The debate around legislation setting interest rate ceilings tends to be emotive. On the one hand there is a strong moral argument for protecting consumers against excessive charges; on the other it can be argued that they distort markets and can contribute to financial exclusion. Both points of view have validity but are almost impossible to reconcile.'

1.6 This observation supports the view, expressed by Iain Ramsay, that 'We do not seem to be progressing to 'The End of History' on interest rate ceilings as nations converge on a modern understanding of what many economists would probably argue to be the futility of ceilings'. While it may be true that 'the wider concern about the moral and social acceptability of usury, at least in the context of non-Islamic banking systems, is now a relative rather than an absolute one', there is little evidence to support the view that interest rate ceilings are disappearing. A March 2008 report on financial services provision and financial

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4 Ramsay, I., 'To Heap Distress upon Distress?' Comparative Reflections on Interest Rate Ceilings (Kent: University of Canterbury, 2009), (hereafter 'Comparative Reflections') available at www.law.utoronto.ca/visitors_content.asp?itemPath=5/7/0/0&contentId=1855 (accessed 21 December 2009), p.3

exclusion for the European Commission found that 'More than half of the countries studied were reported as having interest rate ceilings, including Austria, Belgium, France, Germany, Italy, Netherlands, Poland and Slovakia'. Iain Ramsay suggests that the popularity of caps may be cyclical: 'political pressure for ceilings increases with wealth inequality and during economic downturns'.

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6 European Commission, Financial Services Provision And Prevention Of Financial Exclusion (Brussels: European Commission, 2008),

7 Ramsay, I., Comparative Reflections, Op. Cit, p.4
2 PROTECTION FROM USURY AND EXPLOITATION

2.1 Proponents of caps argue that they protect vulnerable borrowers from usury and exploitation by helping to ensure access to credit at reasonable rates. They are therefore seen as an important consumer protection measure. In a debate at the Transact National Conference 2008, Laurence Girard, Internal Audit Director at ADIE (l’Association pour le droit à l’initiative économique) said, 'It is a very good protection for consumers to have a capped interest rate. These caps have to be fixed at an acceptable level for banks to be paid for the risks that they are taking'.

2.2 One argument is that the poorest people in society often have no alternative but to borrow from high-cost lenders to make ends meet and that, in countries without caps, those lenders can charge whatever they want. A November 2009 report from the New Economics Foundation (NEF) states that 'Nine million people in the UK don’t have access to credit from banks, so have no choice but to use rip-off lenders ... These lenders charge whatever they want – the sky is the limit'. The UK media frequently carries stories of struggling families being charged rates of interest that convert to extremely high annual percentage rates (APRs).

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10 New Economics Foundation (NEF), Doorstep Robbery, p.2

11 See for example: The Daily Mirror, ‘Beware payday loan firms charging 1,700%’, 11 November 2009,
2.3 It is argued that 'a key benefit of capping is the fact that (subject to effective enforcement of the cap) it will remove the possibility of consumers paying a high cost for credit'. The European Commission report on financial exclusion states that 'The purpose of interest rate ceilings is to protect vulnerable people against usury practices, which can be defined as lending at an excessive rate of interest, making profit from the state of need of the borrower'. A campaign entitled 'Taking responsibility in the economic crisis', launched by civic alliance London Citizens in 2009, calls for the UK Government 'to follow the example of France, Germany, Italy and Poland by protecting its citizens by acting to curb exploitative lending (usury) by ... Introducing a maximum limit/cap of 20 per cent on all interest charged on unsecured personal loans by financial institutions (for example, credit card companies, store cards, doorstep lending)'.

2.4 Opponents of interest rate caps state that, far from increasing access to credit and reducing the exploitation of low income individuals, caps

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12 Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps: protection or paternalism? (Brisbane: Griffith University, 2008) (hereafter 'Interest Rate Caps'),


would actually reduce access to credit and could increase exploitation. In explaining the case against caps at the 2008 Transact Conference, Anna Ellison from research consultancy Policis said, 'Interest rate ceilings are often presented as being a consumer protection measure. In contrast, interest rate ceilings damage the interests of the poor'.

2.5 On 21 October 2005, a number of consumer organisations and independent experts wrote a joint letter to Peers in the light of the Second Reading of the Consumer Credit Bill in the House of Lords, setting out their belief that 'the introduction of a rate ceiling would restrict access to credit among low-income consumers; at worst, it could lead to an increase in the use of unlicensed lenders'. During its investigation into the home credit market in 2004-2006, the UK Competition Commission was also persuaded that 'there was a risk that price caps would contribute to a reduction in access to credit for some customers (and thus to a possible increase in financial exclusion).

2.6 In its response to the OFT Credit Review Interim Report, one trade association wrote, 'When demand exceeds supply there is an economic vacuum. Prices rise and alternatives are found. The alternative to regulated consumer credit is informal or illegal lending'. The association refers to research conducted by Skipton Building Society (reported by The Times newspaper in 2007), which found that 'Britons are currently

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owed over £25 billion by their family – an increase of 82 per cent on the £14 billion they were owed 10 years ago'. 19 The association observes that 'This indicates a significant potential for widespread unregulated lending if regulation makes formal, commercial borrowing too difficult, not to mention the social consequences if family and friends have difficulty in repayment'. 20


3 THE USEFULNESS OF APR AS A MEASURE

3.1 It is sometimes argued that interest rate caps are a populist measure representing an over-simplistic response to press reports of consumers paying outrageous APRs.21 In its December 2003 White Paper, Fair, Clear and Competitive, the former Department of Trade and Industry (DTI) said, 'The overwhelming advantage claimed for this mechanism is its simplicity'.22 Opponents of caps assert that a regulatory response focusing on APR levels ignores the fact that APR is a misleading measure for short-term, small-sum loans and distorts the value of many high-cost credit products.

3.2 Iain Ramsay says, 'The economist will coolly explain that this percentage rate is a misleading statistic for a short term loan, that the fixed costs associated with such loans inevitably result in an annualised high rate'.23 David Prosser in The Independent on 3 July 2009 observed that 'the annual percentage rate that is the standard way of comparing loans isn’t terribly useful with very small advances. Payday loans ... typically carry a fee of £20 or so a month in return for an advance of as little as £100 to see the borrower through to payday. That would imply an apr of more than 2,000 per cent – outrageous when you see it written down, but not relevant to what is paid in real life'.24

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23 Ramsay, I., Comparative Reflections, Op. Cit., p.6-7

3.3 Some supporters of caps agree that APR is a misleading measure, but argue that this objection can be dealt with by basing the cap on the total cost of credit (that is, what the debtor would actually repay if he borrowed a particular amount) rather than the APR. In its Doorstep Robbery report, NEF acknowledges that 'There is justified criticism of the use of APR as a price measure of credit. We agree with these criticisms and explain ... the shortcomings of APR and why using the total cost of credit to provide price comparisons would be better'.25 The report concludes with a series of recommendations, one of which is to introduce a cap on the total cost of credit rather than the APR.26

3.4 Gibbons and McCartney state that 'Whilst the vagaries of the APR calculation can sometimes make the cost of short term loans appear unduly high, it is clear that the actual amounts being paid by people on low incomes for these types of credit are extremely high when compared to more mainstream forms of borrowing. The best means of comparison is to annualise the Total Charge for Credit (‘TCC’) per £100 borrowed'.27 Against this, it can be argued that an annualised TCC still has the potential to confuse, particularly for short-term borrowing where the advance and interest/charges are generally repaid almost immediately.

3.5 Other supporters of caps argue that APR is a helpful measure even for short-term loans because it helps consumers to compare different credit products, but say that the frequent practice of rolling-over high cost loans means that a short-term loan often becomes a long-term loan in any case. This may bring back the relevance of the APR. This is an

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26 NEF, Doorstep Robbery, Op. Cit, p.30

argument made by the Center for Responsible Lending in the United States and Consumer Focus in the UK, amongst other organisations.\textsuperscript{28}

4 THE TRUE COST OF LENDING

4.1 Closely related to the debate about whether caps would increase or decrease access to credit for vulnerable borrowers is the question of whether the rates charged by high-cost credit suppliers accurately reflect the true cost of lending. If one takes the view that the charges of many specialist credit products accurately reflect the risks and/or costs of delivering these products, then imposing a cap at levels that are closer to mainstream rates raises the concern that high cost lenders will either restrict the types of consumers that can use the products, or possibly even exit the market.

4.2 Studies, such as the 2005 study by Collard and Kempson for the Joseph Rowntree Foundation, have shown that low-income borrowers have a higher risk of default and tend to prefer making weekly cash repayments for their debt, and both of these factors increase the cost of lending.29 It is argued that interest rate ceilings would not address the reasons for the high costs associated with lending to low-income or credit-impaired consumers30 and if ceilings were set at unprofitable levels, some lenders would raise access hurdles to high-risk borrowers or simply withdraw from the market altogether.31 This would reduce access to credit for borrowers who already have few choices and, in some cases, cause those borrowers to turn to unlicensed money lenders.32 Faisel Rahman, Director of the social enterprise Fair Finance said:


30 Department for Business Innovation and Skills (BIS), Economic Narrative, Op. Cit, para 187


'There are three reasons why doorstep lenders, payday lenders and pawnshops get away with charging anything from 100%-20,000% for short-term loans: collecting the data on people with thin credit files is expensive and laborious; managing defaults can be expensive; and there isn’t enough competition to bring the price down.'

'Setting an interest rate cap could put the legal doorstep lenders and payday lenders out of business ... If you don’t enjoy the luxury of being able to save, the only option left to pay for a school uniform, or fix a broken fridge, would be borrowing from someone who isn’t bound by the law – a loan shark.'

4.3 The opposite view is that the prices charged for high-cost credit reflect market power and are set at arbitrary, inefficient or anti-competitive levels and capping charges at much lower levels would still allow such lenders to operate. Howell, Wilson and Davidson highlight this issue in relation to the debate on interest rate caps in Australia: 'The high cost may be a true cost for micro credit providers in which case a cap will put an end to their business, or alternatively there may be inefficiencies in their product delivery and it might be possible for them to continue to lend within the cap'. In relation to the UK, NEF said:

'... From [one] perspective, a price cap in consumer credit markets would mean that sub-prime lenders could not cover their costs anymore, and hence they would withdraw from this market segment ... This is only true, however, if pricing does accurately reflect risk. Pricing in the sub-prime industry is not transparent, and


35 Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.115
there is some evidence to suggest that prices in the sector are overinflated.'

4.4 The evidence that NEF refers to comes from the Competition Commission (CC)'s Home Credit Market Investigation Report 2006. The CC found that 'customers paid higher prices than could be expected in a competitive market' and estimated that 'the price of an average loan was approximately £20 higher than could have been expected in a market in which competition ensured that prices reflected only the costs of provision. This equated to approximately £7 per £100 of loans issued'.

4.5 In his speech to the All Party Parliamentary Group (APPG) on Credit Unions, Damon Gibbons asked, 'Why would caps cause lenders to withdraw from the market? They are making an enormous level of profit at the moment – in excess of what they would make if the market was properly competitive. If we introduce a cap and that causes some loss of profit – not all of it, but some – why would they withdraw?'


37 Competition Commission, Home Credit Market Investigation, Op. Cit, para 22

5 LEGITIMISING PAYDAY LENDING

5.1 In some countries, the adoption of interest rate ceilings has been opposed by consumer advocates on the grounds that they legitimise what should actually be criminalised - or at least made illegal - and abolished. Canada recently opted for provincial regulation of the payday loan sector rather than an outright ban.\textsuperscript{39} Bill C-26, An Act to Amend the Criminal Code (Criminal Interest Rate) created an exemption scheme from the general applicability of Section 347 provided that (amongst other things) a payday lender operates in a province with an interest rate cap set at a level determined by the province.\textsuperscript{40}

5.2 While the Bill was generally welcomed by consumer and industry representatives, some commentators have been critical of the nature of the caps brought in under the scheme. Commenting on new regulations introduced in British Columbia, a columnist from the Vancouver Sun said, 'for most payday loan shops, which charge a little less than 10 times the legal limit, the change merely legalizes what used to be against the law. It raises the permissible annual interest from 60 per cent a year to as much as 598 per cent'.\textsuperscript{41}

5.3 In April 2008, the Manitoba Public Utilities Board remarked as follows: 'Licensed payday lenders are to be exempted from the application of

\textsuperscript{39} Kitching, A. and Starky, S., Bill C-26: An Act to Amend the Criminal Code (Criminal Interest Rate), Legislative Summary LS-541E (28 September 2007)

\textsuperscript{40} Further details are discussed in Annexe C of the OFT Credit Review's Interim Research Report, available at \texttt{www.oft.gov.uk/ofat_work/markets/services/review-high-cost-consumer-credit} (accessed 5 January 2010). See pp. 46-50.

Section 347, and this will remove a major legal risk for payday lenders … With licensing, payday lenders will be able to continue charging annual percentage rates (APRs) of 100 times or more the lowest rate obtainable by a chartered bank or credit union. It is not surprising that payday lenders sought and encouraged Parliament to act.42

5.4 Similar criticisms have been levelled against the Deferred Presentment Service Transactions Act (DPTA) in the American State of Michigan which provides a regulatory framework for payday lending. According to Europe Economics, 'Many consumer advocates insisted that the passing of the scheme effectively legalised payday lending' 43 An article from the October 2006 edition of the Michigan Bar Journal observed that 'For several years, Michigan's consumer advocates were successful in holding at bay any sort of safe harbor legislation for payday lenders. Then, on November 28, 2005, Michigan enacted its Deferred Presentment Service Transactions Act'.44

5.5 Faisel Rahman of Fair Finance has expressed his opposition to the adoption of interest rate caps in the UK but argues that jail terms for 'irresponsible lending' - to someone who can’t afford the loan you’ve made – would focus lenders' minds'.45

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6 PROTECTING THE PUBLIC INTEREST

6.1 It can be argued that imposing ceilings to remove high interest loans is the right thing to do as from a public policy perspective even if consumers with impaired credit histories and/or low incomes want the opportunity to obtain credit. Therefore, 'demonstrating a demand for fringe products does not justify their continued supply'.

6.2 In a Draft Literature Review for the Consumer Action Law Centre (CALC) in Australia, Neil Ashton wrote, 'it is not accurate to conflate demand with need' and a little further on, 'It is fair to start from the assumption that there is no reason to restrict the supply of goods that satisfy socially harmless demands. To argue, however, that wherever there is demand there ought to be supply, regardless of the social harm, is not helpful'.

6.3 In the University of Cincinnati Law Review, Charles Bruch observed that 'Those outside the [payday lending] industry heartily agree that payday lenders are providing a service; however, they submit that this service is predatory, usurious, and unconscionable, and that in some cases denying credit to an individual is in the individual’s best interest'. Jim Hawkins, in an article for the William and Mary Law Review, wrote that 'Price controls partially address the concerns raised by deficient self-control and miswanting by limiting how much money customers can 'waste' on products that are not in their best interest'. For Damon

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46 Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.23


48 Bruch, C., 'Taking the Pay Out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders' (2001) 69 U. Cin. L. Rev. 1257

49 Hawkins, J., 'Renting the Good Life', 49 WM & MARY L REV 2041 (2008), p.2109
Gibbons, 'Credit should only be given if the extra money will affect the borrower’s life positively during the term of the loan'.

6.4 NEF has stated that, 'The underlying argument for [the] free market approach [to credit in the UK] is that access to any form of credit at any time by everyone is a good thing and that restricting access to credit is detrimental to the poor ... Credit use has become the norm rather than the exception. Instead of closing the gap between income and basic expenditure, the Government has favoured a market-led solution to the problem, which in essence means that credit dependency has risen, and those who can least afford it pay the highest price'.

6.5 In its 1971 Report on Consumer Credit, the Crowther Committee reached a conclusion which was not dissimilar. According to the Committee, 'It is argued that it would be wrong, by imposing a statutory ceiling, to make it impossible for lenders to continue to make loans to borrowers in [the high risk] category. We do not subscribe to this argument. In our view, there is a level of cost above which it becomes socially harmful to make loans available at all, even if the cost is not disproportionate to the risk and expense occurred by the lender'.

6.6 On the other hand, commentators have asserted that it is patronising and inefficient for the state to assume that it knows what is best for low-income consumers and/or credit impaired consumers, particularly since they may need short term credit to cover emergency expenditure. In other words, the argument that denying credit to individuals can be in their best interest is problematic because 'it presumes to 'know what is best' for low income consumers notwithstanding that they may be

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51 NEF, Doorstep Robbery, Op. Cit, p.4-5

52 Consumer Credit: Report of the Committee (Cmnd 4596, 1971) ['Crowther Committee Report'], para 6.6.6
deprived of access to credit as a result'. David Prosser’s article of 3 July 2009 (previously referenced) discussed what he called a nanny-state argument:

'Should we really be legislating to protect people from themselves? ... We should, of course, ensure that borrowers have every opportunity to make informed decisions about the way they use credit .... But improving disclosure standards is not the same as credit control.'

6.7 Iain Ramsay’s 2009 paper, 'Comparative Reflections on Interest Rate Ceilings', discusses another aspect of the public interest argument for caps. He points out that ceilings 'may be intended to address externalities to high cost credit such as state costs of support for individuals who become over-indebted. Eric Posner argues that this was a rationale behind underlying usury in the UK and US. However the UK had no real usury ceilings during the period of the flowering of the welfare state'. In June 1995, Eric Posner wrote that 'the provision of welfare in a free market produces perverse incentives to take excessive credit risks, which both drive up the cost of the welfare system and undermine its goal of poverty reduction. The laws against usurious or unconscionable contracts are desirable because they deter this risky, socially costly behaviour'.

6.8 Europe Economics states that 'The starting point for considering any policy intervention should be a clear identification of the problem that needs to be addressed ... there may be issues specific to consumer

53 Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps , Op. Cit, p.23

54 Prosser, D., 'A credit crackdown is too easy', Op. Cit.

55 Ramsay, I., Comparative Reflections, Op. Cit., p.8

credit concerning systemic risk to the financial system from high levels of debt'. However, it says, 'Avoidance of the build up of debt does not appear to have been a driving force in setting controls on interest rate charges ... Avoidance of the types of systemic risk which have been revealed in recent years requires more fundamental reform of the way in which lenders assess risk'.\textsuperscript{57}

\textsuperscript{57} Europe Economics, Report for OFT, Op. Cit. paras 1.42 and 1.47
7 COMPETITION AND REGULATORY INTERVENTION

7.1 An important argument in favour of the use of caps is that, while price control measures would be inappropriate in well-functioning markets, sources of market failure inherent in high-cost credit markets justify this type of intervention. Europe Economics explains the theory:

'It may be argued that users of this type of credit have few, if any, alternatives to turn to and may need to obtain credit to obtain essential goods and services rather than for discretionary spending. In effect they may face a monopoly supplier who can charge a price above that of a competitive market. They may also be more vulnerable, because of their socio-economic status, to taking on debt without appreciating its full cost.'58

7.2 Iain Ramsay says that, amongst the different rationales for interest rate ceilings, they 'may be justified as a response to behavioural mistakes where individuals are perceived to underestimate the risks of high cost credit' and 'they may be intended to respond to problems in competition in a market which leads to supra normal prices'.59

7.3 Howell, Wilson and Davidson point out that 'An argument can be mounted that in an uncompetitive market regulatory intervention is both justifiable and necessary'.60 Debt on our Doorstep (DOOD) asserts that the evidence provided by opponents of price capping tends to be drawn from studies that examine the effects of caps on competitive markets and that these studies have limited relevance for considering the effects of caps on high cost credit markets in the UK.61

59 Ramsay, I., Comparative Reflections, Op. Cit., p.8
60 Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.22
61 Debt on our Doorstep, A Review of the UK Debate on capping credit charges, Submission to OFT Consumer Credit Review (hereafter 'Submission to Credit Review'), p.2
7.4 It is worth noting that not everyone agrees with the assertion that high cost credit users in the UK may be more vulnerable because of their socio-economic status, or should be described as 'vulnerable borrowers'. In responding to the OFT Credit Review Interim Report, one stakeholder noted, 'Despite the ... initial assertions that users of high cost credit are invariably vulnerable, and do not make wise choices due to lack of time, limited awareness, poor understanding and behavioural biases; the assessment in paragraph 3.26 indicates that the significant majority of customers believe they have selected a good product and a good supplier'.

7.5 As mentioned earlier, the CC itself did not favour the use of price caps as a remedy to the problems it found in the home credit market. Instead, it 'sought to find remedies which will encourage competition in the market for home-collected credit, in the belief that an increase in competitive pressure will serve to remove the detriment of high prices'. Similarly, EE said:

>'If users do genuinely face a monopoly supplier of last resort credit then some form of intervention may be appropriate to control charges. However even within product groups such as payday loans and home credit there is competition between suppliers. Mechanisms for promoting this competition may be more beneficial than imposing price controls.'

7.6 Organisations such as NEF and Debt on our Doorstep (DOOD) argue that the remedies selected by the CC to address competition problems in the

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63 Competition Commission, Home Credit Market Investigation, Op. Cit, para 23

home credit market have proved ineffective and that the time is right to re-consider the use of price caps. In its submission to the Credit Review, DOOD said, 'Whilst these remedies were clearly well intended, they have not been sufficient to ensure a fair price for Home Credit borrowers in the current economic climate. Indeed, there is evidence that prices have increased, competition weakened, and that low income borrowers have fewer options than previously'.

65 Debt on our Doorstep, Submission to Credit Review, p.7
8 UNINTENDED CONSEQUENCES OF CAPPING

8.1 Opponents of caps express concerns that they may not achieve the results intended but have negative, unintended consequences.66

8.2 In November 2006, Jacob Ziegel wrote, 'Section 347 (of the Criminal Code – the 60 per cent usury limit) was adopted by Parliament in 1980 ostensibly with a view to outlawing loansharking. It has done nothing of the kind. Instead of protecting vulnerable borrowers, it has proven to be a major headache for legitimate lenders and other credit granters. It has also generated a large volume of expensive litigation, including half a dozen cases that have made it all the way to the Supreme Court'.

8.3 In his paper examining recent debates in the UK and France on the role of interest rate ceilings in consumer credit regulation, Iain Ramsay provides a summary of some of the arguments relating to the unintended consequences of interest rate ceilings (he refers to these as 'The economic criticisms of interest rate ceilings'):

'They are argued to be both over and underinclusive. They are a 'blunt instrument' since not all high interest loans are necessarily unfair or result in over-indebtedness and not all consumers may underestimate the risks of high cost credit. They may be circumvented … They may have undesirable substitution effects where individuals are forced into less convenient, more costly and less transparent forms of credit. They may result in exclusion where suppliers withdraw from the market. Consumer choices are limited. Ceilings result in hurting most low income consumers who

66 See for example Kempson, E., and Whyley, C., Extortionate Credit in the UK: A report to the DTI (hereafter 'Extortionate Credit'), available at www.pfrc.bris.ac.uk/Reports/Extortionate%20Credit%20in%20the%20UK.pdf (accessed 5 January 2010), p.34
are the intended beneficiaries ... For these reasons other policy instruments ... are proposed.'

8.4 Many of these concerns are discussed in more detail in the individual sections that deal with the benefits and costs of caps. The general conclusion of the case studies that Europe Economics carried out for the OFT Credit Review on Ireland, Germany and the United States was that 'the principal concerns are with information improvement and the operation of competition so that there is a range of credit products and providers with incentives to innovate. If there are wider social issues that governments need to address then a focus on specific areas of concern provides an alternative to a general limit on charges for all credit providers'.

8.5 The 'blunt instrument' argument appears to be one that the Government accepted as one of the reasons to reject caps in its September 1973 White Paper, Reform of the Law on Consumer Credit, and in the subsequent Consumer Credit Bill. The Paper states that

'The Government have decided against setting any statutory maximum rates of charge or continuing any presumption that a particular rate of charge is excessive. This is because the statute will apply to such a wide range of loans ... It would not be realistic to try to set a rate which could be reasonably applied to every type of transaction. Whether a rate is excessive essentially depends on such circumstances as the size and duration of the loan, whether it is secured or unsecured and, if unsecured, the credit worthiness of the borrower.'

67 Ramsay, I., Comparative Reflections, Op. Cit., p.8


69 Department of Trade and Industry, Reform of the Law on Consumer Credit, Op. Cit, para 68
8.6 Some commentators discuss a further possible consequence of interest rate caps: that prices for credit products previously below the capped amount would gravitate upwards towards the cap, thereby enabling lenders to operate a cross-subsidy between lower and higher risk groups. A report by Kempson and Whyley for the DTI in 1999 warned that 'interest rates tend to creep up to the ceiling. This is a particular problem when ceiling rates are deliberately not set too low'.\textsuperscript{70} This was also given by the Government as a reason to reject caps in the debate on the Consumer Credit Bill in the House of Commons in 1973. Former Minister for Aerospace, Michael Heseltine, said:

'The concern about the general question of fixing rates of interest which are a hard and fast barrier is that, in order to deal with extreme cases, we have to pitch the rate of interest relatively high. In the Moneylenders Acts it was pitched at 48 per cent ... But if 45 per cent is charged it is arguable that that is getting more reasonable, simply by working back from the high ceiling introduced in the legislation. It therefore seemed to us better not to fix a firm ceiling which would tend to draw people up to it but to have a set of guidelines which the courts would be able to interpret in order to deal more flexibly with all the systems and problems that will arise.'\textsuperscript{71}

8.7 This is disputed by opponents of caps who argue that 'theory is contradicted here by empirical evidence and the adaptability of business models'\textsuperscript{72} and that 'there is certainly little likelihood that mainstream products will 'gravitate upwards' towards the ceiling, given strong

\textsuperscript{70} Kempson, E., and Whiley, C., Extortionate Credit Op. Cit, p.34

\textsuperscript{71} HC Deb 14 November 1973 vol 864 cc509-98, available online at \url{http://hansard.millbanksystems.com/commons/1973/nov/14/consumer-credit-bill} (accessed 15 January 2010)

\textsuperscript{72} NEF, Doorstep Robbery, Op. Cit, p.27
reputational concerns in that sector'. In this respect the 2004 Policis report supports the arguments of those in favour of a cap in the UK. Policis found that 'Rate ceilings appear to have no impact on the price of credit for low risk borrowers which is determined by competition'.

8.8 While opponents of caps outline the ways in which they can distort markets and reduce product diversity and competition, proponents of capping emphasise the ways in which the absence of caps can distort markets. In the April 2009 edition of Harper’s magazine and a related interview for Democracy Now, Chicago-based lawyer, Thomas Geoghegan, discussed how the dismantling of caps in the United States had helped to draw capital away from the manufacturing sector, which had a much lower return on investment, to the more lucrative world of financial services:

… if you’re able to charge 30 per cent or, in a payday lender case, 200 or 300 percent … you actually want the loan not to be repaid. You want people to go into debt. You want to accumulate this interest. And this addicted the financial sector to very, very, very high rates of return compared to what investors were used to getting in the real economy, the manufacturing sector … So the capital in this country began to shift in the financial sector. That’s why the financial sector began to bloat up.

73 Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.19

74 Policis, Op. Cit, p.20; see also Debt on our Doorstep, No case for a cap?: Why the DTI has got it wrong, available at www.church-poverty.org.uk/campaigns/debt/No%20Case%20For%20CAP.pdf/view (accessed 5 January 2010), p.2

9 CIRCUMVENTION AND ENFORCEMENT OF INTEREST RATE CAPS

9.1 One of the criticisms of caps is that they 'are easily avoided, difficult to enforce and waste regulatory resources'.\(^7^6\) International case studies for the OFT Credit Review suggested that where interest rate caps had been imposed to address the problem of high cost credit, they had often been ineffective. They had frequently been circumvented and in some cases, not properly enforced.\(^7^7\) Europe Economics describe what happened in the United States:

The Marquette judgment (1978) in the USA which determined that credit card operators were bound by the laws of the state in which they were based, not by the laws of the state in which they sold their products, allowed operators legally to bypass state imposed interest rate caps. The development of payday loans has followed a similar pattern although Pennsylvania is strongly resisting this.\(^7^8\)

9.2 Howell, Wilson and Davidson assert that, 'To be effective, a cap must be accompanied by effective enforcement which, it should be acknowledged, is likely to be costly'.\(^7^9\) They quote a study showing that 'The effectiveness of the cap in New York in prohibiting payday lenders from operating there is said to be not so much about the cap, but more about effective enforcement'.\(^8^0\)

\(^7^6\) Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.19


\(^7^9\) Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.19

\(^8^0\) Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.19
9.3 The OFT’s case study of Canada found that, for a variety of reasons, the
60 per cent usury limit was rarely enforced.\(^{81}\)

9.4 There are suggestions that the growing use of the internet for credit
applications could make enforcement increasingly difficult.\(^{82}\) Europe
Economics found that 'The growth of the internet has made it easier for
operators to circumvent state [or] national legislation with on-line
applications and electronic transfer of funds'.\(^{83}\) In Canada, the Manitoba
Public Utilities Board said, 'the Province of Quebec reports no ’payday
lending’ outlets, as a result of provincial law restricting the maximum
interest that can be charged to 35% ... That said ... its residents may be
taking out payday loans from payday firms operating through Internet
and/or telephone and physically located in other provinces'.\(^{84}\)

9.5 One submission to the Credit Review observed that 'The opportunities
for cross border lending brought about by the EU Consumer Credit
Directive will potentially allow out of state lenders to offer loans to
consumers living where regulatory regimes do not allow them to operate,
much in the way that small loans are made available to German citizens
from Switzerland currently. Indeed, online lending from outside the EU or
European Economic Area is a plausible option'.\(^{85}\)

9.6 A related argument is that, where lenders seek to circumvent or
accommodate caps, price transparency for credit products tends to be
compromised. The Scott Report found that consumers in Victoria

\(^{81}\) OFT, Interim Report Annexe C, Op. Cit, para 2.70

\(^{82}\) Europe Economics, Report for OFT, Op. Cit. para 1.40 and 3.14, but note para 9.9; Manitoba
Public Utilities Board, Order No. 39/08, Op. Cit, p.31 and 55

\(^{83}\) Europe Economics, Report for OFT, Op. Cit. para 1.40. See also para 3.14, but note para 9.9

\(^{84}\) Manitoba Public Utilities Board, Order No. 39/08, Op. Cit, p.55. See also p.31.

\(^{85}\) Consumer Finance Association, Response to the OFT Review of High Cost Credit – Interim
Research Report (hereafter ‘Response to Interim Report’), 7 January 2010, para 3
(Australia) were able to enter into high cost contracts despite the presence of interest rate caps because fees and charges other than interest were not included in the cap. In evidence to the UK Treasury Select Committee in 2006, Elaine Kempson said:

9.7 Superficially [an absolute interest rate cap] is a very attractive idea. However, our research with people on low incomes suggests that it is premature while they have such poor access to low-cost credit … It would, undoubtedly lead to a displacement of costs (with more additional charges) so that they would not have to be included in the APR quoted by lenders. This would result in a serious lack of transparency for people who need it most.

9.8 The Committee concluded that 'the Government should continue to encourage the development of measures to promote alternatives to high cost credit and assess the suitability of powers in the Consumer Credit Act 2006 before considering whether to impose an interest rate ceiling'.

9.9 The Policis Report of 2004 had previously reported similar results to Professor Kempson’s research: '… lenders may adapt pricing structures so that less of the ultimate cost of credit to the consumer is captured

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86 Consumer Affairs Victoria (CAV), Small Amount Lending Inquiry 2008 (Melbourne: CAV, 2009)


within the usury cap'; 89 'The main way in which the ceilings are accommodated is that interest rates become less important as a component of the total price of credit'90 and 'Price transparency would appear to be compromised where the cost of credit depends on ancillary and behaviour-driven pricing'.91

9.10 In an earlier report for the former UK Department of Trade and Industry (DTI), Kempson and Whyley also found that interest rate ceilings 'tend to displace costs so that lenders can avoid including them in the APR. So the extent of colourable goods sold on credit tends to increase (Credit Research Center, 1980)' and that 'the ability of some lenders to displace costs and the problem that arises with colourable goods make it almost impossible for consumers (and judges) to compare the costs of borrowing from different sources'.92

9.11 Advocates of interest rate caps do not necessarily disagree that lenders may try to circumvent them in certain circumstances. For example, Debt on our Doorstep (DOOD) notes that 'Simply extending the loan terms by a few weeks can have a significant impact on the final APR. If caps are introduced based on an APR measure then there is a danger that these will simply cause lenders to manipulate the length of the loan in order to evade the intent of the cap'.93 However, proponents of caps point out that this problem can be addressed by adopting the right type of cap.


90 Ibid.

91 Policis, Effect of Interest Rate Controls, Op. Cit, p.25

92 Kempson, E., and Whyley, C., Extortionate Credit, Op. Cit, p.34

93 Debt on our Doorstep, A Review of the UK Debate on capping credit charges, Submission to OFT Consumer Credit Review, p.9
This links with arguments about over-generalising, discussed in the next section.

9.12 DOOD comments that 'In order to ensure that lenders were not able to evade the cap by manipulating APR figures, any cap would need to be based on the Total Charge for Credit. There would also need to be a supplementary power for regulators to prevent 'colourable' pricing practices'. On this last point, it is worth noting Jim Hawkin’s observations on the caps that have been applied to rent-to-own firms in the United States:

Nine [US] states statutorily impose limits on the total costs that rent-to-own firms may charge customers: Connecticut, Hawaii, Iowa, Maine, Michigan, New York, Ohio, Pennsylvania, and West Virginia ...Connecticut’s statute, as an example, notes that lenders are not able to offer rent-to-own agreements where the total payment is more than twice the cash price of the item being purchased.

9.13 Hawkins finds that 'the case for completely banning the rent-to-own transaction is very weak. On the other hand ... policymakers have strong justifications for imposing regulations tailored to address the cognitive defects from which customers are most likely to suffer'.

9.14 In response to the difficulties associated with enforcing caps, one argument is that the costs of effective enforcement should be borne even if they are high. Another is that models of 'enforced self-regulation' (the public enforcement of privately written rules) can lower the costs and increase the effectiveness of caps. Howell, Wilson and Davidson, citing Baldwin and Cave, say that 'such privately written rules are likely

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96 Baldwin & Cave (1999), Cited by Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.20
to be well informed and therefore more effective and appropriate and clearly less likely to lead to a departure of fringe credit providers from the market. Importantly in terms of regulatory efficiency, this model would be less likely to lead to attempts by the industry to circumvent or avoid regulation through loopholes'.\textsuperscript{97} On the other hand, the authors also discuss a number of criticisms of this model including:

The inappropriateness of setting a cap at the point where the products are profitable for suppliers, as opposed to the point at which consumers are adequately protected against the risk of finding themselves in 'debt traps' and 'debt spirals'. The focus of any capping measure should be on what is reasonable and affordable for consumers, and will not cause harm to vulnerable consumers. If a product cannot be offered at such a rate then it is arguable that it should not be offered at all.\textsuperscript{98}

9.15 Another response is to point out that enforcement problems are not an inherent drawback of caps in general, even if it were true that difficulties have been experienced in specific cases. The problems of generalising about caps is discussed in more detail below.

\textsuperscript{97} Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.20

\textsuperscript{98} Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.20
10 GENERALISING ABOUT INTEREST RATE CAPS

10.1 In his paper for the October 2009 Trebilock Symposium, Iain Ramsay said, 'The variety of types of ceilings and their distinct rationales suggest caution in making broad statements about their effects, recognising that studies of the effects of one type of ceiling might not be applicable to other types'.\(^99\) He quotes the example of the usury cap in Canada, which was intended to facilitate prosecutions against loan sharks, and argues that criticising the cap for not being an effective redistributive mechanism therefore misses the point.

10.2 It has been argued that many of the criticisms and unintended consequences associated with caps should not be seen as problems with caps per se but only with the specific type of cap being discussed and the circumstances in which it has been implemented. In commenting upon a report produced by the consultancy Policis for the former Department of Trade and Industry (DTI), DOOD said that 'even if the report's conclusions could be accepted, they only show that it is the level of the cap that is the critical issue. A cap that is set at too low a rate will inevitably cause lenders to restrict access to credit'.\(^100\) Jim Hawkins makes a similar point in relation to the rent-to-own industry in America: 'Usury limits in other credit markets have often resulted in effectively banning credit products. So far, however, the current price controls have not had this effect in the rent-to-own industry because they are high enough to allow operators to function'.\(^101\)

10.3 Howell, Wilson and Davidson discuss the 'concerns regarding the 'blunt' nature of an interest rate cap, and suggestions that a 'structured cap'

\(^99\) Ramsay, I., Comparative Reflections, Op. Cit, p.8

\(^100\) Debt on our Doorstep, No case for a cap?: Why the DTI has got it wrong, available at www.church-poverty.org.uk/campaigns/debt/No%20Case%20For%20CAP.pdf/view (accessed 5 January 2010), p.3

based on calculations of all costs (defined either under the heading of 'fees' or 'interest') of lending, is preferable.\textsuperscript{102} They say, 'This would enable regulatory control over the costs of fringe lending, but in a manner informed by actual costs as demonstrated by empirical evidence. It could be argued that this would allow fringe products to remain available to consumers but on fairer terms'.\textsuperscript{103}

10.4 DOOD’s submission to the OFT Credit Review stated that: 'Any price cap would … need to be set at a reasonable level, and high enough for lenders to make a return on capital but low enough to eliminate excess profits arising from the lack of competition. Setting that level of a cap would require considerable investigation into the economics of high cost credit markets'.\textsuperscript{104} The organisation acknowledges the existence of concerns about credit rationing and market distortion but says, 'there is no reason why these impacts would occur if caps were restricted to non-competitive markets only'.\textsuperscript{105}

\textsuperscript{102} Howell, N., Wilson, T., and Davidson, J., Interest Rate Caps, Op. Cit, p.19

\textsuperscript{103} Ibid. Emphasis original.

\textsuperscript{104} Debt on our Doorstep, A Review of the UK Debate on capping credit charges, Submission to OFT Consumer Credit Review, p.12

\textsuperscript{105} Ibid.
11 PRACTICAL MATTERS

11.1 The Inquiry of Mr Robin Scott MP into small amount lending practices in the Australian State of Victoria in 2008 highlighted the problem of determining the level at which a cap should be set. The Scott Report stated that 'Balancing the needs of consumers and providers is a difficult process. If pitched too low, the cap can damage the market. If pitched too high, its effectiveness is compromised'.\(^{106}\) It concluded that 'Given inconsistent evidence that a ceiling significantly ameliorates the high cost of credit and, the difficulty in determining the appropriate ceiling, a more nuanced policy approach combining more established regulatory tools is preferred'.\(^{107}\)

11.2 Europe Economics found that 'In practice, where caps have been set, particularly for individual forms of credit as in Ireland, they have often been at levels which have had limited impact on the bulk of the businesses being regulated. It appears that the forms of credit rating and a general cultural aversion to debt may be a stronger constraint on the development of new forms of credit in Germany than the case law based interest cap'.\(^{108}\)

11.3 A second practical matter relates to the need for caps to keep pace with changes in the market. It has been argued that jurisdictions with capping systems have sometimes run into problems where updates to the cap had not occurred. One suggested reason for the repeal of Canada’s federal Small Loans Act was that, by 1960 the $1,500 (£850) ceiling had become unworkable due to the dramatic increase in the cost of

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\(^{106}\) Consumer Affairs Victoria (CAV), Small Amount Lending Inquiry 2008 (Melbourne: CAV, 2009)


\(^{107}\) Ibid.

money.\textsuperscript{109} In its submission to the OFT Credit Review, DOOD refers to literature discussing the impact of price caps on the US credit market in the 1960s and problems created by caps in American states not rising in line with the overall cost of credit:

Most of the US studies on the impact of rate caps were conducted at a time when the US had raised central bank base rates in order to counter high levels of inflation. The rise in base rates was then reflected in increased cost of borrowing for credit card providers and caused prices in that market to increase to a level where state usury limits, which had not been increased in line with the wider market conditions, became binding on them.\textsuperscript{110}

11.4 DOOD makes this point to emphasise that many of the arguments presented by opponents of caps would not apply if an effective capping system were to be adopted. It suggests that these practical objections could be overcome if 'floating caps' were used that moved automatically in response to changes in base rates and if caps were applied to competitive markets only. It points out that the 'floating cap' approach, adopted by a number of US states in response to the problems they experienced at the time, proved to be an effective solution.\textsuperscript{111}

11.5 In his paper for the October 2009 Trebilock Symposium, Iain Ramsay refers to a series of documents discussing interest rate ceilings in France and says: 'the discussion illustrates the complexities in establishing and monitoring usury ceilings'.\textsuperscript{112} Ramsay also refers to the French concern


\footnotesize{\textsuperscript{110} Debt on our Doorstep, Op. Cit, p.2}

\footnotesize{\textsuperscript{111} Ibid.}

\footnotesize{\textsuperscript{112} Ramsay, I., 'To Heap Distress upon Distress?' Comparative Reflections on Interest Rate Ceilings, Op. Cit, p.16}
to ensure that cap levels were not subject to arbitrary political interference: 'The 1989 reforms were intended to move usury law away from arbitrary political interventions by linking the rates to changes in market levels'.

11.6 The current legal framework also presents a practical obstacle for the adoption of an interest rate cap by the Office of Fair Trading (OFT). At present, the OFT does not have the power to set a general interest rate cap. Historically, the Moneylenders Act 1927 had a provision that agreements with rates above 48 per cent per annum were presumed to be unconscionable (and thus could be re-opened by the courts), although the presumption could be rebutted by the moneylender providing evidence to the contrary. The presumption was later removed by the Consumer Credit Act (CCA) 1974. The OFT would therefore need a specific power to set a cap which would, in turn, be likely to require primary legislation. Against this, it could be argued that there is nothing to stop the Government introducing legislation to make the necessary changes as soon as Parliamentary time allows.

113 Ibid.


115 Credit unions are unique in the UK in having a legal ceiling set on the amount of interest they can charge for loans [Credit Unions Act 1979, ss11(5) and 11(7)]. This was increased from 1 per cent a month on the reducing balance to 2 per cent a month on the reducing balance in 2006, in recognition of the fact that credit unions found it very difficult to sustainably lend small amounts of money over short periods of time at the previous maximum interest rate.
12 EVIDENCE BASE FOR GOVERNMENT POLICY

12.1 In December 2003, the Government said that it was 'not yet persuaded that the introduction of interest rate ceilings for the UK is the right approach to provide protection from credit costs'. At the same time, it announced that it had commissioned research into the way that interest rate controls had worked in other countries. The research, undertaken by Policis, was published in August 2004, along with a decision that an interest rate ceiling would not be introduced as part of the Government’s plans to modernise consumer credit law. In its report for the DTI, Policis found that:

- Demand for credit appears to be constant irrespective of the regulatory or cultural context, with low income households having an irreducible need for credit.
- There is less product diversity in markets with ceilings.
- Lenders may respond to ceilings by raising access hurdles to high risk borrowers.
- Lenders withdraw from the market where ceilings are newly imposed.

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117 Department of Trade and Industry (DTI), Op. Cit, para 3.52


119 Policis, Effect of interest rate controls, Op. Cit, p.9

120 Policis, Effect of interest rate controls, Op. Cit, p.14

121 Policis, Effect of interest rate controls, Op. Cit, p.15

122 Policis, Effect of interest rate controls, Op. Cit, p.16
Lenders may adapt pricing structures so that less of the ultimate cost of credit to the consumer is captured within the usury cap.123

Rate ceilings are unlikely to cause prices for credit products that are currently below the capped amount to drift upwards towards the ceiling.124

Rate ceilings affect the availability of dedicated sub-prime models and create credit exclusion for those who cannot access mainstream credit.125

Those experiencing credit difficulties in France and Germany appear more likely to suffer significant detriment than their counterparts in the UK and are much more likely to suffer complete financial breakdown.126

The credit impaired in France and Germany appear more likely to use illegal lenders than their counterparts in the UK where there are legal credit options for such borrowers.127

12.2 The Policis Report of 2004 appears to have been quite influential within Government and the wider policy-making community. A January 2005 Commons Library Research Paper on the Consumer Credit Bill noted that 'The Government’s decision not to impose a cap on interest rates has, in

123 Policis, Effect of interest rate controls, Op. Cit, p.16

124 Policis, Effect of interest rate controls, Op. Cit, p.20

125 Policis, Effect of interest rate controls, Op. Cit, p.35


127 Policis, Effect of interest rate controls, Op. Cit, p.40
part, been informed by independent research it commissioned on the effect of interest rate controls in France, Germany and the USA’.\(^{128}\)

12.3 The Griffiths Commission on Personal Debt said, ‘Some members of the Commission were initially sympathetic to the principle of capping because they wished to protect the most vulnerable members of our society. However, in the end, they became persuaded that in the view of the evidence from other countries, capping could end up hurting the very people they were concerned to help. Its conclusion therefore is not ideological but based on the evidence from other countries’.\(^{129}\) In their submission to the Credit Review, Reifner and Knobloch explain that they have been 'informed by [Debt on our Doorstep, a UK-based campaign for affordable credit] that the Policis report of 2004 and a further report by [Policis] of 2006 concerning illegal money lending,\(^ {130}\) have had a significant influence on UK Government policy and contributed to the rejection of usury ceilings as a measure to be included in the Consumer Credit Act 2006’.\(^ {131}\)

12.4 Proponents of interest rate caps argue that the Government’s rejection of caps is based on evidence that is flawed.\(^ {132}\) In its report, Doorstep


\[\text{\footnotesize\textsuperscript{130} PFRC and Policis for the DTI, Illegal Lending in the UK: Research Report, December 2006, available at www.policis.com/publications.htm (accessed 2 January 2010)}\]

\[\text{\footnotesize\textsuperscript{131} Reifner, U. and Knobloch, M., The German Credit Market: How it deals with usury and the credit needs of low income households: Expert Opinion for DOOD (Debt on our Doorstep), Submitted to Credit Review September 2009 (hereafter 'Submission to Credit Review'), p.1}\]

\[\text{\footnotesize\textsuperscript{132} See for example New Economics Foundation (NEF), Doorstep Robbery Op. Cit, pp.2-3, 13 and Appendix 1}\]
Robbery, the New Economics Foundation (NEF) said, 'The research that forms the basis of much of the UK’s stance on price caps stems from reports prepared by the consultancy Policis on behalf of the Department for Trade and Industry (DTI) ... In our opinion, however, there are some question marks over this research'.

NEF’s concerns about the methodology and presentation of evidence in the Policis report can be summarised as follows:

- The Policis Report does not fulfil the basic tenets of social research, such as the need to contribute to knowledge in a reliable, and transparent way.\(^{134}\)
- The report contains many methodological and analytical problems and makes sweeping statements and conclusions that are not supported by the data provided.\(^{135}\)
- There is inadequate sourcing of evidence. For example, 'There is no bibliography, and most data remains unsourced. Where they are attributed to a database, website, book, or article, there is not sufficient information in order to locate the source in question.'\(^{136}\)
- The authors of the Policis report fail to define key terms that were used in the questionnaire. This is a potentially serious drawback because, first of all, interviewees need an understanding of what is meant by these terms in order to place themselves in a category that best matches their circumstances. Second, readers of the


\(^{134}\) New Economics Foundation (NEF), Doorstep Robbery, Op. Cit, p. 31

\(^{135}\) New Economics Foundation (NEF), Doorstep Robbery, Op. Cit, p. 32-33

report need to be aware of the definitions used in order to comprehend the reasoning of the authors.\footnote{137}

- There are problems with the presentation of data in the report. In particular, 'the depiction of data in graphs is misleading and does not adhere to agreed standards, such as providing a legend and using appropriate scales'.\footnote{138}

- The report makes unjustified assumptions. For example, 'The research argues that the situation for poor people in Germany and France is worse, as they are excluded from credit ... Research supporting these claims is driven by the assumption that access to credit is a necessity of modern life and does not question the fact that people on low incomes need credit to fund essentials, and that they have to pay the highest price for it. Following this line of argument, sub-prime lenders ... are seen as a force for good, as they provide an essential service to a market that the mainstream does not, or cannot, serve'.\footnote{139}

12.5 A submission to the OFT noted that there was no comparison of the survey findings with data from the relevant authorities (such as the bank authorities and SCHUFA in the case of Germany) and from other empirical research and therefore no consideration of whether the findings from the Policis surveys are exceptional and the reasons for this.\footnote{140}

12.6 For some commentators, unwarranted assumptions in the Policis report reflect a more fundamental failure to appreciate the differences between the consumer credit systems in each case-study country. For example,

\footnotesize
\begin{itemize}
    \item \footnote{137 New Economics Foundation (NEF), Doorstep Robbery, Op. Cit, p.13 and 31; Reifner, U. and Knobloch, M., Submission to Credit Review, Op. Cit, p.2}
    \item \footnote{138 New Economics Foundation (NEF), Doorstep Robbery, Op. Cit, p.32}
    \item \footnote{139 New Economics Foundation (NEF), Doorstep Robbery, Op. Cit, p.12}
    \item \footnote{140 Reifner, U. and Knobloch, M., Submission to Credit Review, Op. Cit, p.2}
\end{itemize}
Reifner and Knobloch argue that the lack of credit product diversity in Germany has more to do with German banks’ monopoly on the provision of cash credit than the presence of interest rate caps, but that Policis erroneously attributes this feature to the adoption of caps:

'It is clear to see how such a monopoly on the provision of cash credit has acted to limit the types of credit product in Germany as compared to the UK, where non bank specialist lenders are able to establish themselves with ease. However, the Policis report makes no mention of this constraint on the development of the German credit market and therefore sees any differences in this area as a result of the usury rate.'

12.7 It has also been suggested that the difficulties inherent in making cross-country comparisons should be reflected in a more nuanced report, and that the issue of access to credit for vulnerable borrowers needs to be considered holistically, with the debate on caps taking place in the context of a much wider debate. At the 2008 Transact Conference, Rachel Corry from Help the Aged said, 'Countries have different welfare systems – so can cross-national comparisons be truly meaningful?'

NEF has argued that 'a more nuanced analysis of credit regulation, income levels, social welfare provisions, and cultural attitudes to credit is missing from the discussion'. Consumer Focus pointed out that 'it is important to be aware of the different regulatory regimes and national contexts when making any comparisons and the limitations this brings'.

12.8 In response to criticisms about the quality of its research, Policis has stated that its observations rested on a substantial evidence base. It

143 NEF, Doorstep Robbery, Op. Cit, p.12;
144 Consumer Focus, Response to OFT Interim Report, Op. Cit, p.5
explained that a detailed technical appendix for the 2004 study, which is publicly available, underlines the robustness and completeness of the data and the rigour and authority of the analysis which underpinned the study. It maintains that its research methodology was described at a length appropriate to, and with a degree of detail consistent with, a report that was intended to be concise and accessible for a general audience.\textsuperscript{145}

13 INTERFACE WITH OTHER REMEDIES

13.1 The argument that the debate on interest rate caps is too narrow and should take place in the context of a much wider debate on access to credit has been raised by both proponents and opponents of caps. The latter emphasise that other remedies and solutions to problems associated with access to high-cost credit should be properly explored before interest rate caps are considered. They argue that remedies that enhance competition and encourage consumers to shop around are more effective than price control mechanisms that risk distorting competition. In the home credit sector, it has been argued that remedies prescribed by the Competition Commission have not been given sufficient time to work.

13.2 It has also been suggested that debates about the pros and cons of ceilings can be a distraction from the more fundamental issues affecting many low income borrowers, such as poverty and credit-dependency. According to Iain Ramsay, 'The central problem in the UK for many home credit consumers is poverty and the ceilings debate may be a sideshow to this issue'.

13.3 Proponents of interest rate caps do not necessarily disagree with the view that poverty and credit dependency are the fundamental problems but they emphasise that other remedies should be seen as complements of - rather than alternatives to - interest rate ceilings. Referring to UK Government initiatives to expand access to affordable credit, such as the Growth Fund, DOOD said, 'Whilst not disputing that increasing access to affordable credit through these mechanisms is likely to be critical in the longer term, the argument that this is an alternative to price caps is undermined by the fact that very slow progress is being made to scale up provision'.

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147 Debt on our Doorstep, Submission to Credit Review, p.7
The same argument applies to the informational remedies that Government and Regulators have prescribed instead of price caps. In his response to the OFT Credit Review Interim Report, Damon Gibbons - for the Centre for Responsible Credit (CFRC) - argues that 'information disclosure and what has been termed the 'liberal’ model of regulation more generally is not sufficient. We urge the OFT to consider the need for a more fundamental review of its regulatory approach in relation to high cost credit markets as a result and to use more robust consumer protection approaches'.

Damon Gibbons expands on the drawbacks of relying on information disclosure as a consumer protection mechanism in this sector: 'as the [OFT Credit Review] consumer survey goes on to reveal, many consumers [are] completely price insensitive due to their desperate need to access cash quickly and the scope for more information or improvements in transparency to impact on their borrowing decisions is therefore extremely limited'.

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148 Centre for Responsible Credit, Submission to the OFT High Cost Credit Review: Comments on the Interim Research Report and Annexes (hereafter 'Response to OFT Interim Report'), January 2010, para 1.6

149 Centre for Responsible Credit, Response to OFT Interim Report, Op. Cit, para 2.33
14 CONCLUSION

14.1 Notwithstanding the heated nature of the debate, there are perhaps one or two areas of consensus in the debate between proponents and opponents of caps. First, there appears to be some agreement that further empirical research would be helpful in determining the effects of interest rate caps on access to credit for low income consumers.

14.2 In its response to the Credit Review Interim Report, Consumer Focus expressed its view that interest rate caps and their impact should be researched in more depth.\textsuperscript{150} NEF observed that, apart from two reports by Policis (one with the Personal Finance Research Centre), and one presentation, 'there appear to be no other UK reports that empirically investigate the impact of interest rate ceilings on consumers'.\textsuperscript{151} In October 2009, Iain Ramsay cautioned that 'There is no doubt that without systematic empirical research consumer policy making may be an 'exercise in accidental wisdom'\textsuperscript{152}.

14.3 There also appears to be some consensus that a narrow focus on interest rate caps is unhelpful. Opponents of caps tend to emphasise the problems associated with price ceilings and the benefits associated with alternatives 'such as more competition, better information, more warnings, debiasing interventions or even product term regulation'.\textsuperscript{153} Proponents of caps often accept that whilst these controls are certainly necessary, they should be seen as one element in a wider package of measures.

14.4 The London Citizens campaign 'Taking responsibility in the economic crisis' contains five proposals which are designed to support one

\textsuperscript{150} Consumer Focus, Response to OFT Interim Report, Op. Cit, p.5-6

\textsuperscript{151} New Economics Foundation (NEF), Doorstep Robbery, p.13

\textsuperscript{152} Ramsay, I., Comparative Reflections, Op. Cit, p.18

\textsuperscript{153} Ramsay, I., Comparative Reflections, Op. Cit, p.8
another, in recognition of the fact that it would be problematic to have a usury cap without an alternative credit stream for vulnerable borrowers. It aims to both 'raise the floor' (the living wage) and 'lower the ceiling' (the cost of high-cost consumer credit products). NEF's report, Doorstep Robbery, says, 'Introducing an interest rate cap may reduce the availability of credit if there are no flanking measures to improve provision of affordable credit. There is an urgent need to boost social lending, and to increase the number of banked people'.

14.5 After analysing the arguments and assumptions about interest rate ceilings in the UK and France, Iain Ramsay concludes that neither country has 'solved the problem of providing affordable and appropriate credit, particularly for small amounts, to low income individuals. The existence or absence of interest rate ceilings does not solve the problem'. What all of these perspectives suggest is that, whatever the final outcome of the policy debate on interest rate caps, they are unlikely in themselves to represent a panacea to the problems experienced by high-cost credit consumers in the UK.

154 New Economics Foundation (NEF), Doorstep Robbery, p.29

155 Ramsay, I., Comparative Reflections, Op. Cit, p.17
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