All Party Parliamentary Group
Debt and Personal Finance
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citizens advice bureau

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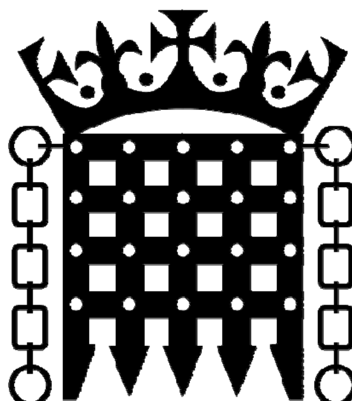

APPG on Debt and Personal Finance – Summary Report on fee charging debt management and high cost credit services

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Consumer detriment in the fee charging debt management and high cost credit markets.

Members of the All Party Parliamentary Group (APPG) on Debt and Personal Finance are concerned that evidence from consumer groups and the experiences of our own constituents point to widespread consumer detriment in the fee charging debt management and the high cost credit markets.

Fee charging debt management services

Consumer groups report that the following problems are widespread in the fee charging debt management sector:

- Pressure selling, including cold calling, unsolicited texts and refusing to observe cancellation rights;
- Misleading information and poor advice;
- Poor service including failing to pass money to creditors and not dealing with the most important 'priority debts';
- Large and non-transparent upfront fees;
- Management fees that are disproportionate to reduction in debts; and
- Failing to keep client money safe.

The experiences of our own constituents support the concerns of consumer groups outlined above.

In September 2010, the Office of Fair Trading (OFT) published the findings of its review into industry compliance with their debt management guidance[1]. The findings of this review support the APPG's and consumer groups' concerns about the prevalence of bad practice among fee-charging debt management companies.

The OFT found that:

- There is widespread non-compliance with the guidance by debt advice and debt management licensees, with most debt management firms audited failing to some extent in at least three areas;
- Misleading advertising is the most significant area of non-compliance, in particular misrepresenting debt management services as being free when they are not
- frontline advisers working for debt management companies generally lack sufficient competence and are providing consumers with poor advice based on inadequate information;
- Industry awareness of the Financial Ombudsman Service scheme for resolving consumer complaints is low and there is widespread non-compliance with the Financial Ombudsman Service's complaint handling rules; and
- The two main trade associations, the Debt Managers Standards Association (DEMSA) and the Debt Resolution Forum (DRF), could do more to lead the way by introducing more robust compliance monitoring and auditing systems for their members.

High cost credit markets

The short term loan sector, particularly the payday loan sector has grown rapidly in recent years. The Consumer Finance Association (CFA), which represents 70 per cent of the UK payday loan market, estimates that payday lending now accounts for around £1 billion in loans annually. Research commissioned by Consumer Focus estimated that in 2009 1.2 millions

[1] **Debt management guidance compliance review (September 2010) OFT**
http://www.oft.gov.uk/about-the-oft/legal-powers/legal/cca/debt-management

adults in the UK had taken out a payday loan and 4.1 million loans were made. The research also estimates that payday lenders generated £242 million in incomes, about 20 per cent of the amount lent[2].

Consumer groups report that the following problems are widespread in the high cost credit market:

- Aggressive marketing through unsolicited calls, texts and emails
- Consumers with multiple payday loans from different companies at the same time;
- Payday debts inflating either through being rolled over one or more times or through default interest and charges;
- Payday lenders using *continuous payment authority* (using bank card details) to take money from borrowers' accounts, leaving borrowers without money for essential expenditure and/or facing unauthorised overdraft charges;
- Aggressive debt collection practices.

For example, Citizens Advice has seen an increase in the proportion of people seeking advice about debt problems who have taken out one or more payday loans, from around 1% of a 30,000 sample of bureaux clients in debt in 2009 to 4% of a similar sample in 2011. Worryingly it was found that clients in the 2011 sample with payday loans:

- have significantly more debts on average than people using other unsecured loans – eight debts on average compare to five on average;
- are more likely to have other high cost credit debts; and
- and are more likely to have other debts with debt collectors or bailiffs.

Citizens Advice Bureaux have also seen clients whose entire monthly income is spent on repaying pay day loan debts and are using new loans to replace their income. This evidence suggests people in long-term financial difficulty with other debts, are much more likely to take out a payday loan to try and deal with these problems.

The experiences of our own constituents support the concerns of Citizens Advice and other consumer groups.

In November 2011 the Department for Business Innovation and Skills and HM Treasury published the Government's response to consumer credit questions raised in its *Consumer credit and personal insolvency review*[3]. This noted 'the upsurge of concern regarding the rapid increase in the use of payday and other instant lending' (p. 3) and confirmed that the Government had commissioned research on the impact of a total cost of credit cap, announced previously in response to concerns raised in Parliament and media about the cost of payday lending.

APPG on Debt and Personal Finance evidence session on fee charging debt management and high cost credit markets

On Tuesday 7th February 2012 the APPG on Debt and Personal Finance hosted an evidence session to explore the regulation of high cost credit and debt management services. The APPG members took evidence from Teresa Perchard, Director of Policy and Advocacy at Citizens Advice; David Fisher, Director of Consumer Credit and Consumer Direct at the Office of Fair Trading (OFT); John Lamidey, Chief Executive of the Consumer Finance Association (CFA); Henry Raine, Head of Regulatory and Public Affairs at Wonga and Melanie Taylor, Director of

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[2] Keeping the plates spinning. Perceptions of payday loans in Great Britain, Burton M (2010) Consumer Focus http://www.consumerfocus.org.uk/assets/1/files/2010/08/Keeping-the-plates-spinning.pdf

[3] Consumer credit and personal insolvency review: formal response on consumer credit (November 2011), BIS/HMT http://www.hm-treasury.gov.uk/consult_consumer_credit.htm

[4] **Credit and low-income consumers: a demand-side perspective on the issues for consumer protection, Ellison et al. (2011) Friends Provident Foundation http://www.friendsprovidentfoundation.org/reports.asp?itemid=312&itemTitle=Credit+and+low%2Dincome+consumers%3A+a+demand%2Dside+perspective+on+the+issues+for+consumer+protection§ion=24§ionTitle=Reports**

External Relations at the Debt Managers Standards Association (DEMSA). The session was chaired by Yvonne Fovargue MP, chair of the APPG.

David Fisher highlighted some of the difficulties faced by the OFT in regulating the high cost credit and debt management industries. He pointed out that at the point at which the OFT licenses a new business limited evidence is available to the regulator to determine whether the company is fit to hold a license precisely because they are not yet operating. Once a business has a consumer credit license, if the OFT believes they are causing consumer detriment and are unfit to continue trading, revoking or suspending their license can take over to two years as all companies have recourse to a two stage appeals process in these circumstances. During this time the company is free to continue trading (and causing consumer detriment) and he noted that in one case the OFT was required to seek a court injunction against a trader who was engaged in illegal activity to prevent him from continuing to trade because they could not simply revoke the license. David Fisher highlighted several examples of successful action the OFT had taken to address bad practice in the fee charging debt management and high cost credit markets but acknowledged that the OFT operates “a very light touch regime” and said that the transfer of responsibility for the regulation of consumer credit to the new Financial Conduct Authority (FCA) would improve regulation. However he highlighted how important it was “for the OFT to remain active and effective over the next couple of years” during the transition period. David Fisher also acknowledged the resource constraints the OFT operates under pointing out that a large multi-national bank pays only £215 per year to the OFT for a consumer credit license, while a sole trader pays only £87.

Teresa Perchard said that the evidence of Citizens Advice Bureau clients experiences pointed to a significant expansion in the size of the debt management and high cost credit industries, and to worrying examples of widespread bad practice. She highlighted the scale of demand for support from people who have run out of money, stating that approximately10 million individuals in the UK describe meeting their debt obligations as a constant struggle and an estimated 2.5 million individuals, according to You Gov, are behind with at least one consumer credit product or in arrears on a household bill or payment. Only 1 in 5 of the people who are struggling with money problems, gets advice from a free debt advice provider. She pointed out that the free advice sector does not have the capacity to meet this scale of demand and so debt management services and pay day lending services, which both serve this “distressed” market by offering products aimed at people who are running out or have run out of money, are filling the gap. She said that because these products are “distress” purchases, consumers do not shop around for the best deal and so a proliferation of providers in these markets does not mean that competition is leading to better outcomes for consumers. She argued that more people are now turning to pay day loan providers as mainstream credit providers have restricted access to or increased the cost of products like credit cards, overdrafts and loans in recent years, and said that mainstream credit providers could play more of role in offering small value affordable credit products.

John Lamidey argued strongly against the case for greater regulation of the consumer credit industry stating that all regulation and legislative intervention had unforeseen consequences and that regulating the industry would reduce credit supply without reducing demand, leading to greater problems. He also cautioned that the transfer of consumer credit regulation to the Financial Conduct Authority (FCA) would create a perception of a regulatory vacuum during the transition period and highlighted the risk that new businesses with a short-termist outlook would enter the market, make money by ripping off consumers and then disappear before the new regime is in operation. He also pointed out that the FCA’s product regulation approach carried the risk that firms would “shape-shift” to avoid regulation attached to specific products. He argued that regulating the process of selling credit, rather than the products being sold, would be more effective for this reason.

Henry Raine made the case that pay day lending products were not only popular with vulnerable

and low income consumers but were also popular with mainstream borrowers who were increasingly using pay day loan products instead of credit cards. He highlighted the need to consider the regulation of consumer credit in the round when considering the regulation of the pay day loan sector, pointing out that a recent report from Friends Provident[4], which analysed the borrowing behaviour of low income users of revolving credit and found that the 50 per cent of lowest income households, have an average debt of £4060 which is up to £4940 for those using credit cards, whilst the average loan debt to a pay day lender is £273. 40 per cent of those surveyed have bank overdrafts and over 37 per cent had credit cards, while only 8 per cent had a pay day loan debt - so "mainstream" credit products are a very important part of the picture of over-indebtedness he argued. He highlighted the importance of making lending decisions based on good data and said that flexibility in lending products was very important because people should not be encouraged to borrow more than they need to or for longer than they need to. He argued that lenders should be required to display "the total cost of credit" to consumers before the sale of a credit product. He argued that this is more useful to the consumer than a representative APR, which can make it appear that it is cheaper to borrow money for longer (as the APR is lower) when in fact the total cost of credit is much lower if the borrowing period is shorter.

Melanie Taylor said that as a trade association, DEMSA were very concerned about the practices employed by some providers in the fee charging debt management industry, and that DEMSA aimed to raise industry standards. She said she completely supported the point made by consumer groups that large up front fees for debt management services are a problem and said she shared the "concern that the focus is on getting somebody to take the service" and not "their long term financial wellbeing and so because of it, some models are actually set up to recoup very quickly to make profits and that's not in the long term interest of the client. Bringing in regulation could potentially address that."

Conclusions and Observations

There is widespread consumer detriment in the debt management and high cost credit markets

Consumers groups, policy makers, industry representatives and Parliamentarians of all political parties are concerned by the evidence of widespread consumer detriment and over indebtedness in both the high cost credit and debt management markets. Addressing this detriment should be a priority for both the regulator and the Government.

Examples of clients who have taken out pay day loans with several providers at the same time or who have been unable to repay their loan on time and so have "rolled over" their loan on several occasions (incurring charges) suggests that irresponsible lending is taking place. We note that the OFT is shortly to conduct a review of compliance in the pay day lending sector and would urge the OFT to take robust action against any firms, which it finds to be non-compliant with its guidance.

In the debt management market practices including charging large up front fees and providing services and advice which are not in the best interests of the consumer continue to be widespread despite the OFT's recent action in this market. The persistence of these problems suggests a serious ongoing market failure requiring action to protect consumers.

However we also note that consumer detriment and over indebtedness are present in the wider consumer credit market. Regulatory action or other proposals for intervention to tackle these problems must therefore also seek to address consumer detriment arising from mis-selling, irresponsible lending, and unfair charging structures of consumer credit products offered by mainstream lenders and home credit providers.

Cold calling and up front fees should be banned

Cold calling and aggressive marketing practices are a gateway to consumer detriment in both the fee charging debt management market and the high cost credit sector. We believe that the Consumer Credit Act 1974 should be amended to prohibit cold calling for consumer credit business (specifically credit broking, lending and debt management services).

Consumers who run out of money and are struggling to cope with debts and make ends meet are often making a "distress" purchase and there are many examples of consumers being bombarded by offers of credit or debt management solutions several times per day and being pressure-sold inappropriate products, which can lead them in to further over-indebtedness. Citizens Advice's recent super complaint and the accompanying report *Cashing In* highlighted that frequently, consumers who had been cold called were not given all of the information about the product or their cancellation rights required by law and that the widespread practice of cold calling creates an opportunity for fraud because consumers do not recognize cold calling as an illegitimate practice.

Up front fees charged for debt management services as well as credit brokering services lead to widespread consumer detriment encouraging a business model whereby firms recoup their profits very early in their relationship with the client offering them little incentive to ensure the long term financial wellbeing of the client or to offer good ongoing customer service. Furthermore up front fees damage competition because clients who have paid a large upfront fee are reluctant to switch providers, even if a better service is available, especially where they may be required to pay further fees to the new provider. We believe that the Consumer Credit Act 1974 should be amended to prohibit lenders, brokers and debt management firms from taking any upfront payment for arranging or setting up a loan or other agreement until that agreement has been concluded in accordance with consumer credit and other consumer protection law. This would prevent debt management companies from charging upfront fees from clients before they have confirmed that an agreement has been reached with creditors and stated what that agreement entails, including whether or not the creditors have agreed to freeze interest and charges.

The Government should consider the effectiveness of the regulatory regime

Consumer detriment is widespread in the high cost credit and debt management markets and there are a large number of rogue operators in both markets. Giving evidence to the APPG, David Fisher stated that the OFT has historically operated a "light touch" regulatory regime. The Government recently announced its decision to transfer responsibility for the regulation of consumer credit to the new Financial Conduct Authority (FCA). As the Government develops its proposals to reform consumer credit regulation, we urge Ministers to consider how the regulation of these markets can be made more effective to better protect consumers in future. Although there are trade bodies representing members of both industries committed to driving up standards, industry self regulation has its limits, not least because it can never cover all operators and we note that the OFT's recent review into industry compliance with their debt management guidance found that the two main trade associations could do more to promote compliance amongst their members.

We note with concern that the OFT does not seem to have all of the powers it needs to take timely and effective action to deal with bad practice in these markets, for example it has no product intervention powers. We are particularly concerned that it can take the OFT over two years to stop a firm which it no longer considers fit to hold a consumer credit license from trading. The transfer of consumer credit regulation to the FCA, which will have a wider range of powers at its disposal is therefore welcome. However, we recommend that the Government grants additional powers to the OFT to suspend a consumer credit license more quickly to allow it to deal effectively with consumer detriment in the consumer credit market during the transition period before the new regulatory regime takes effect. This is particularly important now because

there is a risk that a perception of a regulatory vacuum could invite an increase in rogue behavior in the consumer credit market during the transition period. We urge the Government and the OFT to set out their plans to ensure that consumers are appropriately protected during the transition period.

The way in which regulation and enforcement is funded is also a key issue which needs further consideration

We note that the cost of consumer credit license for a large multi national company is disproportionately low at just £1075 for a five year license equivalent to just £215 a year. Good regulation benefits good businesses and large businesses should pay a proportionate contribution to the cost of maintaining effective regulation and enforcement.

Low income consumers need access to appropriate and affordable credit products and debt advice services

Approximately 10 million individuals in the UK describe meeting their debt obligations as a constant struggle and the Money Advice Service estimates that currently only 1 in 5 people who are struggling with money problems, get advice from a free debt advice provider. Whilst it is our view that there is a strong argument for more effective regulation of both the high cost credit market and the fee charging debt management market, we acknowledge that any regulatory action may have unintended consequences by restricting the supply of these services without reducing demand.

Low income consumers need access to appropriate and affordable credit products and debt advice services, which will support them to take positive steps to deal with their money problems, not lead them in to greater indebtedness.

There is a need for a sustainable cross government strategy for the provision of free independent debt advice, to guarantee that people have access to advice services appropriate to their needs about the most appropriate debt remedies for them, free from commercial pressure and regardless of their disposable income.

There is also a need for a sustainable cross government strategy for the provision of affordable and appropriate credit products, which must consider the role of mainstream financial service providers and national and local Government as well as the role which can be played by credit unions and the not for profit sector.

In addition we are concerned that some fee charging providers use search engines to promote themselves at the expense of free debt advice providers, even where the consumer has specifically searched for a free debt advice provider by name. In many cases it is not immediately clear to the consumer that they have not contacted the free debt advice provider they were seeking. We would urge the Government to take action to ensure that that free debt advice is clearly shown as an available option for debt advice when consumers conduct internet searches for support.and to require fee charging providers to make customers aware that free to user alternatives are available.