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Business, Innovation and Skills Committee

Debt Management

Fourteenth Report of Session 2010–12

Report, together with formal minutes, oral and written evidence

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Business, Innovation and Skills Committee

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The current staff of the Committee are James Davies (Clerk), Neil Caulfield (Second Clerk), Louise Whitley (Inquiry Manager), Peter Stam (Inquiry Manager), Ian Hook (Senior Committee Assistant), Jennifer Kelly (Committee Assistant), Pam Morris (Committee Assistant), Henry Ayi-Hyde (Committee Support Assistant).

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1 Introduction

1. A November 2011 report, produced by R3, the insolvency trade body, found that 60% of individuals were worried about their debt levels, the highest ever levels of concern over debt.[1] That figure confirmed to us the importance of our inquiry into debt management.

2. Our call for evidence was deliberately wide in order to capture views on both consumer credit and debt advice. The two issues are clearly related and Citizens Advice has highlighted the importance of looking at both of these areas together. Poorly regulated lending and collections practices can cause or contribute to unmanageable debt problems. People struggling to manage their debts can become vulnerable to unfair practices by firms offering credit or debt management services as a way of dealing with debt problems. This is why CAB money advisers often describe people as falling into a 'cycle of debt' or a 'debt spiral'.[2]

3. The written evidence highlighted two particular areas of concern: payday loans and commercial debt management companies. This inquiry therefore focused on those two issues, taking evidence from academics and consumer groups to identify the problems with payday loans and commercial debt management companies and then from representatives from across the high cost credit sector and the commercial debt management companies themselves. Finally we took evidence from the industry regulator (the Office of Fair Trading), the new Government advice body (the Money Advice Service) and Ed Davey MP, the Minister responsible for these matters in the Department for Business, Innovation and Skills.

What is a pay day loan?

4. A payday loan is a short-term loan which provides credit until 'payday' when it will, in theory, be paid back. Payday loans can be applied for either in person at a specialised high street store, for example the Money Shop, or online with companies such as Wonga. The OFT has classified payday loans as high cost credit alongside "pawn broking [...] other short-term loan sums, home credit and rent-to-by credit".[3] Payday loans are becoming a significant part of the high cost credit sector and in its written evidence, the Department set out the size of payday loans in relation to other types of high cost credit:

Breakdown of high cost credit market	
Home collected credit	£4bn typical APR 3-400%
Payday loans	£1-2bn (Approx) typical APR 2500%
Pawnbroking	£1-2bn (Approx) typical APR 100%
Bills of sale (Logbook loans)	£30-£40m typical APR 4-500%

BIS submission Ev 56

1 R3 'Personal Debt Snapshot: Zombie debtors emerge', November 2011- p 03

2 Ev 76

3 OFT, *High Cost Credit Final Report*, June 2010 p 3

Debt advice

5. While the provision of debt advice can have a positive influence on individuals, commercial debt management companies are categorised by the Office of Fair Trading (OFT) as one of the 'high risk' industries it regulates.[4] This is because debt management services are a 'distress' purchase; consumers seeking debt management help tend to be over-indebted, vulnerable and desperate for help. Research by the Money Advice Trust has shown that consumers do not shop around for debt management services.[5] Consumers are potentially committing themselves to a debt solution which can affect their lives for years. The risks if things go wrong can be significant, potentially leaving consumers in a worse financial position, which in some cases can include the loss of the consumers' home.[6]

4 Ev 140

5 Ev 141

6 Ev 141

2 Regulation of the Market and Government Policy

Consumer Credit Regulation

6. Both payday loans and commercial debt management companies come under the Consumer Credit Act 1974, the Consumer Credit Act 2006 and the Consumer Credit Directive. The Government states that the purpose of consumer credit regulation is to:

> Support people's access to credit, ensure fair treatment for consumers from lenders, and provides safeguards to help prevent people from getting into unsustainable levels of debt.[7]

The Consumer Credit Act 2006 updated and amended the 1974 Act to make it more relevant to today's consumers. It was fully implemented in October 2008.[8] The Consumer Credit Directive was adopted by the European Council in May 2008, and legislation implementing its provisions came fully into force on 1 February 2011.[9]

Government Policy and Consultations

7. The Coalition Agreement set out the Government's commitment to the reform of financial services regulation, to curbing unsustainable lending and to the strengthening of consumer protections, particularly for the most vulnerable in society.[10] To deliver on that commitment, the Government has undertaken a number of consultation exercises designed to frame policy developments in this area.

8. *A new approach to financial regulation: consultation on reforming the consumer credit regime,* was a joint consultation run by the Department for Business Innovation and Skills and HM Treasury. The consultation, which ran from 21 December 2010 to 21 March 2011 considered the merits of transferring responsibility for consumer credit regulation from the Office of Fair Trading (OFT) to the proposed new Financial Conduct Authority (FCA)[11]. The Government said in opening the consultation it believed that:

> Transferring consumer credit regulation from the OFT to the FCA provides an opportunity to significantly improve the way consumer credit is regulated and to create a simpler, more responsive regime. [12]

We asked the Minister for an update on the consultation and he told us:

7 BIS website Consumer Credit Regulation: www.bis.gov.uk/policies/consumer-issues/consumer-credit-and-debt/consumer-credit-regulation

8 http://webarchive.nationalarchives.gov.uk/+/http:/www.berr.gov.uk/whatwedo/consumers/consumer-finance/credit-act-2006/index.html

9 BIS website Consumer Credit Directive: http://www.bis.gov.uk/policies/consumer-issues/consumer-credit-and-debt/consumer-credit-regulation/ec-consumer-credit-directive

10 BIS Managing Borrowing and Dealing with Debt: Call for Evidence in support of the Consumer Credit and Personal Insolvency Review p2

11 The FCA was previously referred to as the CPMA.

12 http://www.bis.gov.uk/policies/consumer-issues/consumer-credit-and-debt/consumer-credit-regulation

> We are still analysing all the responses to the consultation and working closely with the Treasury, and we will be announcing our response early in the new year. I am afraid I cannot pre-empt that here today, Chair.[13] [...] one of the issues we will be looking at is the power and resources for the consumer credit regulator.[14]

Equally, when discussing the future of consumer credit regulation the Treasury Minister Mark Hoban MP told the Treasury Committee that "the Financial Services Bill is an opportunity to legislate for that."[15]

9. The Draft Financial Services Bill was introduced to the House of Commons on 26 January 2012. It "provides powers to effect a transfer of consumer credit regulation from the Office of Fair Trading to the FCA".[16] The Treasury website explains that

> The Government will exercise these powers if and when it has identified a model of FCA regulation that is proportionate for the different segments of the consumer credit market.[17]

10. **The consultation closed on 21 March 2011. The Treasury Committee said in January 2012 "[we] are disappointed that 7 months after the consultation closed, the Government has yet to make up its mind". We are concerned that the introduction of the Financial Services Bill has changed nothing by announcing the need for further consideration. In the meantime consumers and the industry are left without clarity on how the consumer credit market is to be regulated in future. We expect the Government—within six months—to outline a timetable and methodology for how and when a decision will be made on whether the power to transfer consumer credit from the OFT to the FCA is to be exercised.**

11. In October 2010, the Department issued its consultation paper, *Managing Borrowing and Dealing with Debt.* In July 2011, the Government published a summary of responses on consumer credit along with its formal response on personal insolvency. In November 2011, the Government published its formal response on consumer credit. Both of the Government's responses put a strong focus on a 'voluntary approach', which it argued avoided burdening business with new regulations and also meant that "consumers do not have to wait for regulations to come into force before increased protections are introduced".[18]

12. The Government summarised its vision for the consumer credit market as being two-fold:

i. First, we want all consumers to be empowered to make better choices for themselves. Consumers should be free to borrow if that is what they decide is in

13 Q 217

14 Q 232

15 Oral evidence taken before the Treasury Select Committee: Financial Conduct Authority, 8 November 2011, HC 1574 Q 246

16 Draft Financial Services Bill, Explanatory Note para 13

17 http://hm-treasury.gov.uk/consult_consumer_credit.htm

18 Forward p 3– 'Consumer credit and personal insolvency review: summary of responses on consumer credit and formal response on personal insolvency' July 2011

their best interest. It is not for the Government to pass judgement on whether a particular product is good or bad but, in line with the Coalition principles of freedom, fairness and responsibility, we want to provide consumers with the tools they need to make informed decisions.

ii. Second, we want to ensure there is a safe and fair regulatory framework for both credit and personal insolvency. These frameworks must protect vulnerable consumers, particularly those at risk of falling into or those already in financial difficulty, and drive rogue companies out of the market.[19]

It has proposed further work on:

a) Consumer Credit – improve protections in the high cost credit market; and

b) Debt Advice – the importance of free and independent debt advice and concerns regarding the debt management industry.[20]

The regulator: Office of Fair Trading (OFT)

13. The OFT describes its mission as ensuring there are:

> competitive, efficient and innovative markets where standards of consumer care are high, consumers are empowered and confident about making choices, and where businesses comply with consumer and competition laws but are not overburdened by regulation.[21]

Licensing

14. Under the 1974 Consumer Credit Act the OFT is responsible for licensing firms engaging in consumer credit activities. It assesses businesses' fitness to engage in licensable credit activities before they are granted a licence and then monitors the firms' continued fitness. The Consumer Credit Act 2006 gave the OFT extended powers including the right to judge a firm's "competence" to engage in regulated credit activities—before that the OFT could only consider whether the individuals who ran or controlled the business had any convictions for fraud, dishonesty or violence or whether they had engaged in unfair business practices in the past.[22]

15. The OFT regime is fully funded through licensing fees. Its budgeted income for 2011–12 is approximately £10 million which is raised by a fee of £435 for sole trader or £1,075 for other firms when applying for or renewing a licence. The fee is collected on a five-year cycle which is equivalent to an annual fee of £87 or £215 respectively. In addition, all firms pay a flat levy of £150 to fund the Financial Ombudsman Service, which the OFT collect on its behalf alongside the licensing fee.[23]

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19 Ev 55

20 Ev 55

21 Ev 139

22 Ev 139

23 Ev 141

16. The level of scrutiny of any new entrant, even following the 2006 Act, has received criticism. Teresa Perchard from Citizens Advice said that "basically, if you are an out and out criminal with a record of violence or discrimination, which is one of the other areas of the law, you will not get a licence, but beyond that you do not have to prove any technical competence to get into the market".[24] She went on to state that any new entrant would not be tested on their knowledge of the market, their business capability, the law governing the sector or even "whether you have enough money to run a decent business".[25] Sarah Brooks, representing Consumer Focus agreed with that assessment and argued that given the "compliance problems" in this sector, the licensing fee "does not buy you an awful lot of supervision".[26]

17. Vivienne Dews, Executive Director, Credit Group, OFT, acknowledged that resources were a constraining factor on its work:

> It is run on a self funding basis. It has so far been run on the basis that we keep resourcing levels quite low. This is a matter that we agreed with the Government. [...] I think there is a debate about whether those resourcing levels should be higher, which would be met through an increased licence fee, in order that we could do more enforcement work. That is something that I think is a debate to be had with Government in the near future.[27]

18. David Fisher, Director, Credit Group, OFT, accepted that the flat fee system was a fairly blunt tool and could benefit from refinements:

> Would it be helpful to us to differentiate fees according to the nature of your business and market, and in particular the level of actual or potential risk that you pose to people taking out loans and other related services? The answer to that is yes.[28]

19. The Consumer Credit Counselling Service (CCCS) believed that an increase in the cost of the credit licence also had the potential benefit of driving out "some of the bad players in the market".[29] However the OFT pointed out to us that the cost of the credit licence could not be used as a barrier to entry.[30]

Guidance

20. A key role of the OFT is to provide 'guidance' to those that it licenses. However as David Fisher, OFT told us:

> I sometimes find that people perhaps think the name "guidance" is a bit of a misnomer. We call it guidance because that is what the Consumer Credit Act calls it.

24 Q 41

25 Q 41

26 Q 41

27 Q 190

28 Q 191

29 Q 53

30 Q 193

> It is more than guidance. It is not soft law, as some people call it. It is not a rule, as the FSA are capable of doing, but it is effectively setting out to businesses the minimum standards that we expect of them, and we illustrate it with examples of business practices that we would regard as irresponsible and that go to the question of whether they are fit to hold a consumer credit licence.
>
> So we make it very clear to industry that we expect them to comply both with the letter and the spirit of the guidance. If they do not, and we have good evidence that they do not, we will take that into consideration when we are considering asking ourselves the question, "Does this company remain fit to hold a consumer credit licence?" be it as a debt management company or any other in the sector.[31]

21. The OFT has recently carried out a *Debt Management guidance compliance review*. The results of which are discussed later in the report. Early this year the OFT will be reviewing compliance with the *Irresponsible Lending Guidance* in the payday lending market, the results of which we will read with interest.

Powers

22. The future of regulatory responsibility for consumer credit was under review at the time of our inquiry and no firm decision has yet been taken on whether or not this role will move from the OFT to the Government's new Financial Conduct Authority (FCA). Wherever it is to be based the question of the powers of the future regulator was raised in evidence to us. Martin Lewis, of moneysavingexpert.com highlighted the fact that the OFT currently has fewer powers than the Financial Services Authority (FSA) and that the FSA was "a lot more stringent than the OFT'.[32] The OFT acknowledged that fact and pointed out that, for example, unlike the FSA it was unable to require companies to provide information on a regular basis because "the Consumer Credit Act regime does not operate on that basis".[33]

23. The OFT explained that if a business did engage in activities which it considered to be unfair or improper then it could issue a warning letter or impose requirements on the firm's licence. For example it could require firms to cease particular behaviours or to put in place processes to safeguard against future misconduct. If requirements were then not adhered to it could levy fines of up to £50,000. If the OFT considered that a firm's behaviour was so serious that it was not fit to trade it could take steps to revoke its licence – and this did not need a 'requirement' to be issued first.[34]

24. As we mentioned earlier, the OFT did get new powers in 2008. David Fisher from the OFT saw this as an improvement to the OFT's ability to act and had "made a difference in terms of our ability to test competence and investigate companies, once licensed". In addition, he also highlighted that those changes allowed the OFT to "more proactively and

31 Q 204

32 Q 42

33 Q 185

34 Ev 140

effectively investigate those people: to visit them on their premises, to require them to provide information".[35]

25. However, several of our witnesses thought more was still required. Consumer Focus argued that:

> I think [OFT] have a very tough job to do. We wanted to have a competitive credit market; we thought that might bring down costs, etc., but it has not, actually—it has just made it more difficult to police. I think they are trying to do a very difficult job in difficult circumstances, and perhaps they are not always given the full tools they need to carry it out.[36]

Mark Lyonette from the Association of British Credit Unions (ABCUL) agreed:

> One of our problems with the OFT [...] is that new bad practices spring up all the time and whether they have the resource and ability to always spot them is questionable. [...] It is very frustrating because these little things keep appearing. [...] I am not always sure there is enough resource and perhaps enthusiasm to deal with some of them quickly enough.[37]

26. This concern was not limited to consumer groups. The Debt Managers Standards Association (DEMSA), one of the debt management companies' trade bodies, also believed that the OFT could benefit from enhanced powers:

> At the moment, if the Office of Fair Trading decide to put, are minded to revoke, notice on a consumer credit licence, it will take possibly 12 to 18 months for that to be finally sorted out with appeals, etc. And in that time the company can still trade. I think there perhaps should be a more immediate sanction that can be imposed.[38]

27. Vivienne Dews of OFT, highlighted which additional powers would be helpful:

> The thing we would most like would be the power to suspend a licence. [...] If we were looking at how we could increase our powers, that would be top of our list. It has been discussed with Governments in the past. I do not think there is any debate about whether it would be a useful thing to do; there has not been an opportunity to give us that power, but there is no real debate about it.[39]
>
> There are some other less clear things we would be interested in. For example, the power to ban a particularly harmful product would be one of those. Those and the point about resourcing would be the key points we would make.[40]

David Fisher of OFT, argued that a regulatory redress scheme could also benefit the OFT.[41]

35 Q 191

36 Q 48

37 Q 102

38 Q 135

39 Q 214

40 Q 214

41 Q 214

28. The power to suspend or revoke licenses was discussed with the Minister. However, the Minister was unable to give us any clear indication of Government thinking on this issue because he did not wish to "prejudge the response" of the Government to the consultation on the consumer credit regulatory regime as it had not been "finally agreed" with HM Treasury.[42]

29. **It is clear that improvements should be made to the regulation of the debt and credit industry. The Government's review of consumer credit regulation should be seen as an opportunity to address the many current shortcomings. In framing its new approach we recommend that the Government put in place the following reforms:**

- **That higher licensing fees should be charged for higher-risk credit businesses to allow for greater levels of assessment of competence and fitness to operate.**
- **That a fast-track procedure be developed to suspend credit licences; and**
- **That the regulator be given the power to ban harmful products.**

Public Information Campaigns

30. Given the fact that we took evidence in the run up to Christmas, we asked the Minister if the Department was considering any public information campaigns over the Christmas period to warn against the risks of high cost credit and debt. The Minister told us that there would be "a number of campaigns over this period", including specific campaigns targeted at young people to ensure that they understood the issues of managing debt as there had been a rise in the number of young people getting debt relief orders.[43] This would be in conjunction with Citizens Advice.[44] He also told us that the Government was running an Illegal Money Lending project and a Christmas borrowing campaign, to make people aware that they should not go to illegal money lenders.[45]

31. **We welcome the Government's proposals for Christmas campaigns on debt amongst young people and illegal money lending. That said, we do not believe that the timing of these campaigns—which only started in December—gave sufficient time to gain traction with the public and we recommend that future campaigns start in October. We further recommend that the Government, in its response, sets out the measurable impact on consumers of last year's campaign.**

42 Q 262

43 Debt Relief Orders (DRO): Similar to bankruptcy, these are only available for individuals with low assets and little disposable income.They were brought in during 2009 to provide wider access to debt relief for those who cannot afford to enter an arrangement with creditors or go bankrupt.The key difference between bankruptcy and a DRO is that there is no debtor's estate in a DRO

44 Q 223

45 Q 223

3 Payday Loans

32. Payday loans are designed to be short-term loans for unexpected expenditure to tie people over until pay day. As we have already highlighted, payday loans have been one of the main subjects of concern in evidence to us.

33. Figures from Consumer Focus indicate that the payday loans market increased from 0.3 million borrowers in 2006 to 1.2 million in 2009 to 1.9 million in 2010.[46] The concern is that as the market grows so will the problems associated with it.[47] Citizens Advice give advice to 2 million people a year and they have found that of those people the number who have payday loans has gone up fourfold in the last couple of years. The Consumer Credit Counselling Service (CCCS) told us that, of the 400,000 people a year it advises, one in eight now had a payday loan.[48] Ms Elson from Money Advice Trust said:

> We started collecting data on payday loans a year ago when they started to become an issue; we were getting 200 calls a month then, and it is over 1,000 calls a month now.[49]

34. The OFT described a similar picture of complaints:

> Alongside this growth [in the number of payday lending companies], we have seen an increase in reported consumer harm, particularly over the last 12 months. The overall level of complaints to the Financial Ombudsman Service about payday lending is low, relative to some other products, but increasing. We understand that 81 complaints cases were completed or closed between January and November 2011. This is an increase of 72% over the same period last year, and the rate of increase in complaints upheld is 171%. In addition to this, since 1st January 2011, there remain 180 open complaints about the sector. By way of comparison, completed or closed cases about the home credit sector are decreasing (by 26% this year) with a 50% decrease in the number of complaints upheld. Complaints to Consumer Direct have shown a greater increase, from 700 complaints in 2010 to 1535 complaints in the first eleven months of 2011. We are seeing similar patterns in complaints passed to us by debt advice agencies.[50]

35. These experiences were also backed up by a recent report by R3, the trade body of the insolvency service, which worryingly found that:

- 3.5 million British adults were considering taking out a payday loan over the next six months;
- Of those sampled who took out a payday loan, 60% regretted the decision and 48% believed the loan has made their financial situation worse; and

46 Keeping the plates spinning—Perceptions of payday loans in Great Britain, Consumer Focus, August 2010

47 Q 39

48 Q 41

49 Q 10

50 Ev 142

- Only 13% believed their payday loan had a positive impact on their finances.[51]

Who uses payday loans?

36. Dr Gathergood, an economist at the University of Nottingham, defined the market as being used by two types of people:

i. people who have had a financial shock and need money quickly to address that, who intend to repay, will be in a position to repay and need the money now, a payday loan can act as a high cost but effective form of insurance; and

ii. people who lack control in their expenditures and might take out debt in order to purchase something they want at short notice without an ability to repay, a payday loan is an opportunity for them to be a victim of their own behaviour.

37. Dr Gathergood suggested that payday lenders were keen to associate themselves with the former group, who need short-term credit to meet a specific need. However he cautioned that by providing such loans payday lenders were "opening themselves up to a client base who might be more impulsive and make poor use of credit".[52]

38. When they came before us, payday loan companies explained why they believed their client base was widening. Caroline Walton, of Dollar Financial representing the Moneyshop, noted that increasing numbers of people were using payday loans "as an alternative to going into unauthorised overdraft", and that an increased awareness of this alternative form of lending was directing people away from "borrowing long-term higher values or borrowing in the unauthorised overdraft arena".[53] Ms Walton went on to assert that:

> People are seeing a real, viable choice between the alternatives that they have had and what they could get today from a payday lender, so I would not suggest that desperate times have driven people to a payday lender. Incomes that are being constrained, people on pay freezes, overtime being cut and fluctuating pay packets mean that people have made an alternative choice.[54]

Regulation

39. Martin Lewis of moneysavingesxpert.com argued that the absence of regulation over payday loans was a key factor in the expansion of activity in this sector, and that the United Kingdom was "the only wild west for payday lenders" and "a crock of gold at the end of the rainbow for payday lenders who have been shut down all over the world and have been

51 R3 'Personal Debt Snapshot: Zombie debtors emerge' November 2011 p 03

52 Q 19

53 Q 85

54 Q 85

regulated".[55] He went on to assert that "this is a massive growing problem that is only going to get worse unless there is some form of radical and quick intervention".[56]

40. However, the Minister did not recognise this description of the sector and pointed out that the OFT regulated the sector under the Consumer Credit Acts.[57] John Lamidy from the Consumer Finance Association (CFA), one of the trade associations representing payday lenders, also argued that payday lending was regulated "in exactly the same way as all other consumer credit lending" and included requirements for companies to "provide the pre-contract information, the right of withdrawal and all the things that everybody else has to do".[58]

41. As was discussed earlier, the OFT currently has responsibility for the payday loans market in respect of issuing credit licences and in monitoring compliance with its guidance on responsible lending. However, adherence to that guidance is seen by consumer organisations as an area of concern. Consumer Focus told us that "firms do not obey the rules such as they are" and thought this was partly because payday lenders now had too big a share of the high cost credit market to supervise.[59]

42. Citizens Advice agreed and highlighted the main areas of non-compliance as being in the use of rollovers, credit checking and the handling of debt. It concluded that payday lenders were "not all in full compliance with regulatory guidance on handling customers in financial difficulty".[60]

43. When questioned the OFT highlighted its two key areas of concern with payday lenders. The first was around transparency and in particular the need for consumers to understand properly, the products they are buying:

> It is not a market in which consumers shop around a lot, and we are keen to be sure that they understand what they are buying, what they are getting, what the terms are—that they can compare the cost of products, particularly the total cost of credit.

The second issue was related to credit checking as well as the consumer's understanding of whether the loan was affordable:

> We are concerned about whether, in those quick turnarounds in particular, consumers are being given adequate explanation of what they are getting and whether the lender is assessing the affordability of the credit that is being granted and whether it will push the consumer into unaffordable levels of credit.[61]

44. **We were pleased to hear that the OFT will be carrying out a compliance review of payday loan companies early in this year. In view of the rapid proliferation of payday**

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55 Q 40

56 Q 40

57 Q 226

58 Q 81

59 Q 41

60 Q 47

61 Q 179

loan companies, the Government will need to act swiftly to counter any evidence of non-compliance reported in the OFT's review.

Rolling over loans

45. A key concern with payday loans is the way in which they are used. Citizens Advice argued that while they were intended to be short-term, small-value borrowing to get a borrower to the end of the month, the reality was that providers were "rolling over loans and people never get to pay them back".[62] R3's research found that a third of those who took out a payday loan could not pay it off, so had to get another one.[63] Citizens Advice also highlighted that consumers were using the loans to pay off other debts.[64] Joanna Elson from Money Advice Trust agreed with this assessment:

> There is a process where you can roll over the loan for a short period of time. Every time you roll it over, of course, you have an additional charge. That is where people get unstuck. They do not realise that, very quickly, they are into a big spiral. If they use it for the purpose that perhaps it was intended, which is a stop-gap, once, that is fine. If that is not understood, and it is used in the way that many people are now using it, it can definitely exacerbate things.[65]

46. Consumer Focus explained that rolling over or taking out a loan five times, represented "a long-term credit facility" and therefore was not a suitable service to buy from a payday provider. Its research pointed to the fact that the average number of loans that consumers have in the payday loan market was 3.2 and that urgent action was needed to avoid this figure from getting worse.[66]

47. The rolling over of loans was also recognised by commercial debt management companies. They found that payday loans were exacerbating the debt problem because borrowers were using them in the short term to pay off debts rather than dealing with the root causes of their debt problems. This resulted in consumers getting into more debt before seeking help. Chris Davis, representing MoneyPlus Group, said that his company was now seeing a greater proportion of consumers who had "gone to a payday lender and perhaps rolled over and then gone to another payday lender".[67] John Fairhurst from Payplan also saw this as a serious concern. He told us that Payplan had seen cases where clients had "an excess of 20 payday loans" and that they had been using payday loans as "a way of managing [their] deficit budget".[68]

48. **The evidence we heard has left us in no doubt that the Government must act to limit the rolling over of loans in its review of this sector.**

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62 Q 39

63 R3 'Personal Debt Snapshot: Zombie debtors emerge' November 2011- p 03

64 Q 40

65 Q 17

66 Q 17

67 Q 117

68 Q 118

Cap on total cost of credit

49. Various consumer groups have been campaigning for a cap on the total cost of credit to prevent payday loans from spiralling out of control especially through rollovers. Martin Lewis argued:

> If I were doing this, I would put a total cost cap on. I would talk to the decent players out there about what the total cost cap should be. I would make them portray total cost, which includes all possible fees, which they do not do right now.
>
> As a concept, if you borrow £100, you should never have to pay back more than £150. That is roughly how I would do it; I would base it on cost. Do not take the £50 as my limit—that is conceptual. That would incorporate any number of rollovers, which would be effectively a ban on the number of rollovers going on.

However, he warned that there also needed to be a way of preventing consumers who had reached their limit with one lender and were unable to pay it off—then going on to another lender to borrow to pay off their first loan thus creating a "personal rollover".[69] Consumer Focus said that consumers were already "borrowing from here, there and everywhere, [...] robbing Peter to pay Paul."[70]

50. Despite a large number of responses to the Government's consumer credit review calling for a cap on the total credit that could be charged, the Government said that there was a lack of hard evidence about the impact that the proposal would have. It has therefore commissioned the University of Bristol to carry out research into this area. The Government highlighted that other research had shown that price controls, such as a limit on APR, could restrict availability of legal credit to low income consumers and push them to loan sharks.[71]

51. However, there is already positive research available for the Government on the total cost of credit cap. A report by the Centre for Responsible Credit highlighted the situation in Ontario, Canada where there is a cap of $21 per $100. The Ontarian Government carried out huge amounts of research before putting this into place—through the Maximum Total Cost of Borrowing Advisory Board. It consulted with industry, social, poverty, consumer and financial groups and other experts. It also considered the experience of other jurisdictions with a payday lending marketplace including the review of materials on payday lending across Canada, in the United States and overseas. In addition, the Board commissioned its own research from Ernst & Young.[72]

52. **We do not see the need for Government to commission research, with all the associated costs, from the University of Bristol on the capping of total credit costs given the amount of evidence and research available on the Canadian and US market. If**

69 Q 43

70 Q 45

71 'Consumer credit and personal insolvency review: summary of responses on consumer credit and formal responses on personal insolvency', July 2011, chapter 6.3 p 26-27

72 CFRC: How to regulate payday lending: learning from international best practice, December 2011

Government continues to believe that new research is necessary, it will need to set out which specific areas lack existing data.

Credit checks

53. The OFT has described credit and affordability checking as a key part of being a responsible lender and stated that companies which did not carry out appropriate affordability assessments were falling foul of its guidance.[73] Despite this clear view, a number of our witnesses asserted that not carrying out credit and affordability checks was a regular practice of payday lenders. Consumer Focus claimed that some of the payday loans companies were even advertising that there would not be a credit check for loans. As well as not carrying out credit checks payday lenders were also not registering their loans. Sarah Brooks, representing Consumer Focus, said that non-recording was "fairly commonplace practice among the payday loan market".[74]

54. Martin Lewis agreed that credit checking was a problem with payday providers and argued that given the fact that there were only three main companies which operated credit checking—Call Credit, Equifax and Experian—it was not very difficult for regulators to check which companies were not recording loans.[75] Consumer Credit Counselling Service (CCCS) informed us that the data coming into its social policy team raised questions "about the level of credit checking that goes on" and why individuals who were struggling to repay their debts were still able to get payday loans.[76]

55. The Consumer Financing Association (CFA), one of the trade associations representing payday lenders, argued that a factor in non-reporting by payday loan providers was that the current credit reference agencies were unable to capture the payday sector of the market because "they were built up on mainstream lending and their data is normally only refreshed once a month. That is not good enough for us, because the whole length of the loan may only be a month".[77]

56. Some American states have a real-time central database where payday lenders are required to enter the details of all loans they provide within their state into a database, and to check a borrower's status on the database prior to granting a loan. This allows for a limitation on the number of payday loans that can be obtained at any one time to be enforced, and prevents borrowers from taking out loans from multiple providers at the same time.[78] Veritec, an American firm which had been working in the payday loans market in the USA for over a decade argued that such a database enabled regulators in USA to effectively enforce regulation of payday lending by providing real time intelligence that delivered an accurate and up-to-date view on market data and lender/borrower

73 Q 199

74 Q 46

75 Q 47

76 Q 41

77 Q 83

78 CFRC: How to regulate payday lending: learning from international best practice, December 2011

behaviour.[79] This is a key factor missing from the UK credit reference agencies as the CFA explained it was only updated monthly.

57. There is a general lack of data in the payday loans industry in the UK. The OFT said that they did not routinely collect data on the payday loans market.[80] The Centre for Responsible Credit's recommendation from October 2010 that the payday lending industry should provide independent academic researchers with access to payday customer data to help understand the industry[81] had been ignored.[82] This has meant that the UK's understanding of the sector lags significantly behind the USA and Canada and the UK has to rely on information from abroad.[83] However, we note that the Government has recently asked the OFT to start collecting data.[84]

58. **It is clear that credit checking is a key factor in ensuring appropriate lending to consumers. We are therefore deeply concerned with the evidence that payday providers are not recording all of their transactions. Examples of credit databases that do capture payday lending are available in other countries and we recommend that the Government require industry to introduce similar models in the UK as a matter of urgency.**

59. **In addition we further recommend that payday lenders be required by law to record all loan transactions on such a database so that consumers' credit histories can be accurately monitored. We further recommend that the Government explores how this mechanism can be used to limit the practice of switching between payday loan companies and the subsequent rolling over of loans.**

The Florida Example

60. The Centre for Responsible Credit (CFRC) recently published a report on the international experience of regulation for payday loans[85] highlighting the example of Florida. In 2001, Florida implemented new regulations on payday lending that stipulated a maximum loan sum of $500, limited transaction fees to $10 (in effect a cap on the total cost of credit), banned rolling over, restricted loan terms to a maximum of 31 days, and imposed a cooling-off period of 24 hours between loans. In addition, Florida maintains a real-time database of all loans.

61. This example was highlighted during the backbench debate on 1 December 2011. Yvonne Fovargue MP said that:

> Evidence from Florida shows that capping the total amount that people can take out in any one period—for example, $500 in a year—improves their ability to pay back

79 Ev 168

80 Q 183

81 "Payday lending in the UK: a review of the debate and policy options", Gibbons, D., Malhotra, N., & Bulmore, R. (2010) Centre for Responsible Credit,. London

82 CFRC: How to regulate payday lending: learning from international best practice, December 2011

83 CFRC: How to regulate payday lending: learning from international best practice, December 2011

84 Qq 182 and 183

85 CFRC: How to regulate payday lending: learning from international best practice, December 2011

> that loan. We asked whether that sent people into the hands of illegal lenders, but we were told that the average amount that people take out in loans in Florida is $388, which is quite a bit below the $500 limit. People do not max out their loans, which may mean that they do not go anywhere else.[86]

Nic Dakin MP also highlighted the success of the Florida model:

> Interestingly, by 2009, 6.8 million loans had been authorised in Florida, and not a single loan was extended beyond the contract period. More than 90% paid back their loan within 30 days and more than 70% repaid on the contract end day. Consumer complaints of mis-selling dropped significantly, as did overall indebtedness, and not one borrower was indebted by more than $500 at any given time.[87]

62. The evidence from Florida also suggests that regulation and capping of credit does not lead to the closing down of the payday loans industry; thereby restricting access to credit and pushing people to illegal lenders as suggested by the OFT as being a risk. In fact since the regulations were introduced Dollar Financial—represented in the UK by the Moneyshop—bought into the Florida market acquiring 23 stores in 2006 and a further 82 in 2007. The company even described the regulatory environment as 'favourable'. And yet at the same time its UK representative, Caroline Walton, who met us, only mentioned the negatives of regulation "certainly in the US there have been rate caps, which have meant that payday lending has been closed down in certain states".[88] She went on to suggest that regulation would be "a rather rash" response and that rather than solving problems with the payday industry it would drive out payday lenders and make "it far less competitive".[89]

63. The CFRC highlighted research on Florida by the University of Massachusetts which indicated that despite regulation the payday loans industry was "flourishing" and growing rapidly in terms of the number of customers and number of transactions.[90] CRFC conclude that:

> This evidence flatly contradicts the arguments that caps on the total cost of credit or other restrictions, such as in respect of the number of rollovers allowed will result in a contraction of payday loan availability.[91]

64. **We recommend that the Government studies the Florida example to see what lessons can be learned for the UK market on successful regulating of the payday loans market.**

Use of continuous payment authority

65. A continuous payment authority is similar to direct debit because payments are taken from an account which is linked to a credit or debit card and the company has control over

86 HC Deb, 1 December 2011, col 1157

87 HC Deb, 1 December 2011, col 1165

88 Q 93

89 Q 94

90 University of Massachusetts Report, July 2010 – 'Perspectives on payday loans: the evidence from Florida' para 1

91 CFRC: How to regulate payday lending: learning from international best practice December 2011

how much is debited and when. However, the difference is that a continuous payment authority is not covered by any bank guarantee and can only be cancelled directly with the business that holds the authority. Consumer Focus told us that payday lenders which use continuous payment authorities can "keep dipping in" to a customer's bank account even when they are experiencing difficulties in repaying the loan.[92]

66. Vivienne Dews Executive Director, Credit Group, OFT said that a distinction needed to be made between acceptable and unacceptable use of a continuous payment authority:

> If a continuous payment authority is used correctly simply as a means of making the agreed repayments, we do not have an issue with that. We do have an issue if it is used improperly to take money at times when it has not been agreed and without proper authority. We draw quite a distinction between proper use of it and improper use of it. [93]

David Fisher, Director of the Credit Group at the OFT confirmed that the OFT was aware of concerns about the misuse of the continuous payment authority, in particular:

> Creditors dipping into your bank account, sometimes many times in the day, and taking out sums of money that they may not have agreed with you and at times that you might not have agreed.[94]

Vivienne Dews, defined this as an 'unacceptable practice' which was made clear by the OFT Debt Collection Guidance. However, she also informed us that the 'definition' of 'unacceptable' had been challenged by the industry, and as a result the OFT would be launching a short consultation on the continuous payment authorities.[95]

67. **Whilst we recognise that although the use of continuous payment authority is legal in the payday loans market its use must be carefully monitored. We welcome the OFT's consultation on this matter and recommend that clear rules be put in place to outlaw companies accessing funds without prior agreement. We further recommend that the Government make clear to payday loan companies that if they do not demonstrate a commitment to moving away from the continuous payment authority as the method for receiving payments, the new regulator will be asked to address this matter as a priority.**

Consumer credit code of practice

68. The Governments' response to its consultation on consumer credit made clear that its priority for reform was through 'self regulation'. Building on that approach, the Minister told us:

> We are now engaged in intensive discussions with the four associations who represent over 90% of the payday lending market to see whether or not through

92 Q 41

93 Q 203

94 Q 199

95 Q 199

codes of practice we can have significantly enhanced consumer protection. I have written to the associations and I intend to meet them. I am making a very clear signal to them that some of the practices that I think you are referring to, whether it is the rollover, the continuous authority, irresponsible advertising or a need for greater transparency, all need to be addressed in codes of practice.[96]

69. However, problems with how the consumer credit industry could self regulate have been highlighted to us. Professor Iain Ramsay from the University of Kent warned:

The balance of self regulation versus regulation clearly depends a lot on the context; I am not so confident in an area like payday loans how exactly self regulation would work. Who would enforce it? Would it apply only to companies that had signed up to the code of practice? Would it be enforceable by the Financial Ombudsman Service in terms of a norm of fairness? There is the danger that self regulatory codes actually make the law more opaque because you have to look at the statute, look at the regulations then look at the code of practice, so it is not necessarily the case that it simplifies the regulatory landscape.[97]

70. It should be noted that there is already a code of practice for the industry. Following publication of Consumer Focus' Report: *Keeping the Plates Spinning*, the industry established a forum to draw up a Code of Practice. *A Lending Code for Small Cash Advances* was launched by the Consumer Finance Association in July 2011. However, Consumer Focus argued that while some progress had been made which would be helpful for consumers, "it did not address key issues for the protection of vulnerable consumers which our research had identified".[98] It went on to argue that:

The willingness of industry to work on self regulation is strong but it is doubtful that the measures we would like to see put in place will be achieved by any voluntary code. We consider that consumers are only likely to get the full level of protection they need from regulatory measures to both limit the number of loans/rollovers and to oblige the industry to undertake appropriate credit checking activities.[99]

71. When we asked a representative from the payday loans industry, John Lamidey of the Consumer Finance Association (CFA), what sanctions there were against any payday lender who did not adhere to a code he stated that the current version of its code of practice did not include "compliance monitoring or a method of dealing with members who do not comply" but that the latest revision would "have annual compliance monitoring and a complaints handling system enshrined in that".[100]

72. In Canada the payday industry has established a code of conduct which goes far further than the UK's current version. The Canadian code amongst other things prohibits the rolling over of loans and the issuing of multiple loans at the same time. Interestingly, Dollar Financial—the largest payday operator in Canada and the largest store front payday

96 Q 231

97 Q 25

98 Ev 91

99 Ev 91

100 Q 103

operator in the UK through the Moneyshop—is signed up to the Canadian code[101], which supports that it would be possible for a similarly strict code to operate in the UK.

73. **For self regulation to be effective it has to include transparent and enforceable sanctions. We understand that more vigorous codes of practice are under development by the industry. The Government must ensure that self regulation can deliver the necessary enforcement sanctions and demonstrate that they are sufficient to protect consumer interests. Therefore, we recommend that the Government provide us with an update on the development of the codes of practice by the end of 2012. If it cannot be demonstrated that self regulation can deliver the necessary protections then the Government will need to intervene with statutory regulation.**

The use of APR

74. The standard way in which the cost of a payday loan is measured is by using the annual percentage rate (APR). This measurement and the way that it is calculated is set by the Consumer Credit Act 1974. As the OFT explains on its website:

> The APR must be included in credit agreements and pre-contract information. A typical APR must be included in most credit advertisements. This is intended to help consumers to compare the cost of different credit deals.
>
> The APR is based on the total charge for credit (TCC) which includes interest and other charges which affect the cost of borrowing – even if they are not payable under the credit agreement itself. The APR is an annualised rate reflecting the timing of such charges, as well as the rates and amounts.[102]

75. Both sides of the high cost credit argument agree that using the APR as the price comparator is not ideal for payday loans. It is believed that although companies have to advertise the APR of a payday loan the customer is far more interested in the actual cost.

76. The consumer money expert Martin Lewis, gave us the following example of the difference between the perception generated by quoting APRs and 'real' money costs might have for short term loans:

> I think first of all, to go back to basics, one of the great problems is the APR percentages that companies are asked to produce are a farcical nonsense when it comes to short-term borrowing. I always use this example, [...] If we were in a pub and you said, "Lend me £20", and I said, "I will give you £20 but buy me a pint next week," and the pint cost £3, that is—I will not test you—143,000% APR. That is the problem with APR regulation on short-term borrowing because £3 on £20, over a week, if you compound it over a year becomes 143,000%.
>
> The first problem here is that these lenders are advertising 5,000%. It means nothing and it is not putting people off. There is no price competition in this market, because if there were then nobody would do it. The current idea of comparison sites, which is

101 CFRC: How to regulate payday lending: learning from international best practice, December 2011

102 The Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011

> a plan, is relatively weak; it is not about price. What we first of all would do is incorporate total cost. This should all be about cost; get rid of rates—rates are nonsense. Companies should have to dictate the cost of the loan, and there should be a limit on the total cost of any individual transaction, which includes rollovers[103]
>
> I think total cost, based on a number of examples, is a good idea. There are ways to formulate this within the industry. That is the way it has to go on short-term lending. It has to be: if you borrow £100 over two weeks, you will repay this amount. That is what we need to be telling people. How would you compare if you were doing it yourself? You would ask yourself that question. If I borrow £100, and I pay it back in two weeks, how much would it cost me? If I pay it back in another two weeks later, how much will it cost me? It is the simple and bleeding obvious answer, if I am honest.[104]

77. Caroline Walton, representing the payday lender The Moneyshop agreed:

> The customer actually sees it in terms of pounds and pence, and they make that comparison with others in the same sector in terms of pounds and pence. Also, when they talk in terms of the difference between a payday and an unauthorised overdraft, they have no APR to compare with, so again, they see it in terms of how much they have had to pay at the bank as opposed to paying for a payday loan. I think measuring it in terms of the cost in pounds as opposed to a percentage APR would be very beneficial.[105]

78. When we questioned the Minister he said that while there were "no direct plans" to introduce new measures he acknowledged that the APR measurement was "often not be the most informative measure of the cost of credit".[106]

79. **We recommend that APR should no longer be used to measure and compare the cost of payday loans. Instead, the total cost of the loan should be made clear; for example if £100 is borrowed and £150 is paid back including interest and fees then this total amount is the figure that should be advertised. It also should include how much it costs if paid back a week late, 2 weeks late and so on, so consumers are clear of the reality and penalties of late payment.**

Credit Unions and the Post Office

80. Credit Unions in Britain are small, co-operative financial institutions. There are currently approximately 400 credit unions in the UK serving about 900,000 people.[107] The Credit Union Act 1979 sets down the Credit Union operating principles in law:

- The promotion of thrift among members;

103 Q 43

104 Q 49

105 Q 104

106 Q 233

107 Q 66

- The creation of sources of credit for the benefit of members at a fair and reasonable rate of interest;
- The use and control of their members' savings for their mutual benefit; and
- The training and education of members' in the wise use of money and in the management of their financial affairs.[108]

81. In the past decade, British credit unions have trebled their membership and assets have expanded four-fold. The Association of British Credit Unions Ltd (ABCUL) informed us that the sector has made over half a million loans in the last four or five years, all in the £200 to £400 area.[109]

82. As this growth has taken place, the role that credit unions can play—both in providing equitable financial services to the whole of their communities and providing diversity in the financial services sector—has been increasingly recognised by government and policy-makers. The Coalition's Programme for Government committed to promoting mutuals as part of a diverse financial services system. The Department for Work and Pensions is currently conducting a feasibility study, the outcome of which will determine whether and how an earmarked £73 million credit union modernisation and expansion fund will be invested in the credit union sector. In addition, the Government recently introduced a Legislative Reform Order to amend the Credit Unions Act 1979 intended to enable credit unions to reach out to more people.[110]

83. Joanna Elson from the Money Advice Trust argued that credit unions were a very useful source of both affordable credit and simple savings. However, she acknowledged that this was not at the scale that would be needed to cope with complete demand across the UK. In that context, she welcomed the Department for Work and Pensions' work with the credit unions on modernising and growing the sector but, warned that "you cannot wait for that to happen before you sort out some of these other problems".[111]

84. Professor Iain Ramsay of the University of Kent also noted that credit unions were "a tiny part of the UK market at the moment" and that whilst he was in favour of encouraging them to grow in terms of providing an alternative form of competition in the market he believed that "they can only be one part of the solution to high-cost credit."[112]

85. Mark Lyonette, Chief Executive of ABCUL was also of the view that credit unions were not in the best position to compete with the "high-tech, payday-lending Wonga model" because they were not able to match the "sophisticated automation and credit scoring behind the scenes" which were deployed by those companies.[113] However he highlighted the situation in the United States where credit unions have now successfully entered the payday loan market:

108 Ev 66

109 Q 107

110 The Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011

111 Q 35

112 Q 35

113 Q 107

> I should say that about 90 million people use credit unions in the States. They angsted for a long time over whether they should offer an alternative to the payday lending product. In the end, a number of them did at a much lower cost with the same features—for example, eight days, ten days or the end of the month.[114]

86. The Minister was encouraging on the role of the credit unions, in particular on the potential for them to work within the Post Office network. He highlighted the work currently being done by the Department for Work and Pensions on credit unions and the fund made available by Government to invest in the credit union sector over the spending review.[115] He was of the view that:

> If you could access credit union payments over the Post Office network, and they were there and able to advertise credit union products, I think it would be the biggest shot in the arm imaginable for the credit union sector.[116]

87. There was a suggestion that Credit Unions should be signposted from payday lenders so that people are aware that there is a lower cost alternative. ABCUL explained:

> In the same way that there is an obligation in the debt management industry to make people aware that there might be cheaper or free alternatives available, it might be something that is worth thinking of in this area. You would not be able to recommend any particular institution; it would be more like a wealth warning where you actually suggest that there might be cheaper ways to do this.[117]

88. **Credit Unions have a valuable role to play in this market and their role needs to be highlighted by Government. We support the argument that the Post Office network has huge potential to work with the Credit Unions to provide short-term loans at a lower cost than commercial payday lenders. We recommend that the Government set out in its response, how it proposes to use Post Offices as a vehicle to expand the Credit Union market.**

Social fund

89. The current welfare system provides grants and interest-free loans from the discretionary part of the Social Fund to help people on low incomes with costs which are difficult for them to meet from their regular income; for example to buy school uniforms or to replace white goods. Grants and loans are currently administered by Jobcentre Plus. The budget for the discretionary Social Fund in 2011–12 was £732 million.[118]

90. Under the Welfare Reform Bill, the discretionary Social Fund will be abolished in April 2013. Instead, in England, a new system of Local Welfare Assistance will be introduced, to be administered and provided by local authorities.

114 Q 107

115 Q 240

116 Qq240 and 241

117 Q 110

118 WMS, 31 March 2011, Social Fund Allocations

91. Loans will be replaced by "payments on account". These will be recoverable payments intended to help towards meeting the expenses which are difficult to budget for out of normal benefit income or for which the claimant has been unable to save, or to deal with fluctuations in expenditure throughout the year, for example where children in the household who would normally have free school meals are on summer holidays.

92. The Government says that the reasons for the change include the increase in the cost of loans and the need to focus discretionary payments on the most vulnerable people. The Government also believes that a discretionary system is likely to be more effective if it is administered locally and "linked to other support services" rather than being centrally administered.[119]

93. Martin Lewis described what was happening to the social fund as "just horrendous"[120] and highlighted what he saw as serious problems with the Government's approach:

> It is going to become discretionary for local councils going forward, and I do not see, with the budget cuts at the moment, that they are going to be offering them. What we used to do is have a state-funded social fund that was there to supply short-term lending for people in emergencies, and in the midst of the payday loan boom, we are taking it away. I do not get that.[121]

94. However, the Minister said that the argument that the inability of the benefits system to deliver loans was driving people towards payday loans had not been raised with him. However, he undertook to "talk to DWP colleagues" about this matter.[122]

95. **We are concerned by anecdotal evidence which suggests that the removal of the Social Fund will push people towards payday and other high cost lenders. In its response to this Report, we will expect the Department to set out what meetings—at Ministerial and Official level—have already taken place on this issue; and to set out what joint plans Ministers from BIS and the DWP have put in place to ensure that the Social Fund and the proposed 'local welfare assistance' will protect the most vulnerable from payday and other high cost lenders or loan sharks.**

119 Impact Assessment, paras 4-6

120 Q 52

121 Q 52

122 Q 288

4 Debt Advice

Introduction

96. According to the Government there are in excess of a million consumers each year seeking advice on how best to deal with the financial difficulties they face.[123] These consumers access that advice through a wide variety of providers but two distinct approaches are available, the free to client debt advice and paid-for debt management:

Free to client debt advice

i. **Charities**: for example the Money Advice Trust (MAT) which runs the National Debtline, and Citizens Advice (and their local bureaux). Some of these charities receive central government and/or local authority funding. For example MAT operates a funding model in which a tenth of its income is "self-generated" and the remainder is funded 70% by private sector voluntary contributions and 30% by central government contributions. Funding ratios vary significantly across organisations; some charities, particularly local ones, may receive a majority of their funding from government via their local authority. Charities which operate this model tend to provide holistic debt advice, and often very detailed support to individuals, for example by explaining options, ways of negotiating with creditors, writing letters to creditors, helping clients create personal budgets) but they do not provide formal debt management plans[124] or individual voluntary arrangements (IVAs).[125]

ii. **Direct government advice**: from the housing or welfare department of a local authority.

iii. **Fair share advice**: this model is operated by Consumer Credit Counselling Service (CCCS) and Payplan. They provide debt management plans, individual voluntary arrangements (IVAs) and other formal debt solutions to individuals. These plans, and the associated debt advice, is free to the individual at every stage. Funding is received from creditors on a pro-rata basis according to the amount of debt repaid through these formal plans.

Paid-for debt management

iv. **Commercial debt management companies**: provide formal debt management solutions such as debt management plans and individual voluntary arrangements (IVAs). They charge their clients through upfront fees and ongoing management

123 Consumer credit and personal insolvency review: summary of responses on consumer credit and formal response on personal insolvency BIS and HM Treasury para 5.14

124 Debt Management Plans (DMPs): are formal but non-statutory repayment plans agreed between debtors and creditors, often by a third party (who may or may not take a fee).DMPs are not binding on creditors or debtors.Some may involve a degree of debt write-off

125 Individual Voluntary Arrangements (IVAs): were introduced in 1986 and are a binding statutory contract between debtors and creditors.It is usually a five year repayment plan involving some debt write off. Once approved by creditors, the IVA will be supervised by an Insolvency Practitioner

charges. Such companies include Gregory Pennington, MoneyPlus Group, Debt Advisory Line, ClearDebt and Baines & Ernst. It is this form of debt advice that is of particular concern to us as we highlighted in the introduction.

Commercial Debt Management Companies

97. It was estimated in a review of the sector by the OFT that commercial debt management companies (DMCs) make £250 million a year from over-indebted clients.[126] Following our call for evidence on consumer credit and debt management we received many submissions criticising DMCs. Which? accused the industry of “mis-selling, cold-calling, mis-leading advertisements and inflated claims”.[127]

98. Joanna Elson from the Money Advice Trust argued that one of the problems with DMCs was the speed with which they assessed debtors circumstances which ran the risk of delivering inappropriate solutions:

> If you look at some of the advertising out there, you will see on these websites a 30-second debt test that will tell you whether you are eligible for a Government-backed IVA—surprise, surprise, you are, and then you are down this route. We take 15 minutes at National Debtline to work through with people, and we do not believe you can do it in less than that. We are forever trying to keep the times down because we want to be efficient, but we do not believe you can in all conscience give people a proper solution and work through their problems in 30 seconds. I think that is indicative of the problems that we have.[128]

99. Further concerns of what was happening in the industry were highlighted by a study of debt management plans (DMPs) by R3, the insolvency trade body. Their research of those debtors on DMPs found that 10% of individuals in a fee-charging DMP were not told that they would be charged until after their plan began.[129]

100. As explained in the introductory chapter, DMCs are currently regulated in a similar way to payday lenders—through the OFT. The OFT licenses companies, produces *Debt Management Guidance* and monitors companies’ compliance to the guidance. In doing this the OFT has come across many examples of bad practices such as firms sending out misleading mailings to consumers, using ‘look-alike’ websites to mislead consumers into believing that they were charity-based sources of free debt advice, and being engaged in cold calling.

101. Between April 2008 and June 2010 the OFT undertook 37 formal actions against debt management companies. However despite these actions the OFT did not believe the industry was responding appropriately to concerns and so launched an in-depth review “into the sector as a whole”.[130] The OFT review of DMCs was published in September 2010.

126 OFT: Debt Management Guidance Compliance Review September 2010 p 4

127 Ev 171

128 Q 35

129 Ev 161

130 OFT: Debt Management Guidance Compliance Review September 2010 p 5

It found that 129 of 172 commercial debt management companies were not complying with OFT industry guidelines. OFT told us:

> Frankly we would be the first to say how very, very disappointed we were to discover how little credence seemed to be given to the guidance. But what did we do? We took rigorous enforcement action[...]; I think something like 53 companies exited the market immediately following that as a result of the work that we were doing.[131]
>
> The next step is the revised version of the Debt Management Guidance, which will come out in the new year, which will very explicitly pick up on some of the concerns that we identified with the review. That will set a new and even higher standard that we will expect people to comply with. If we find evidence that businesses do not comply in any significant way with that guidance, we will take enforcement action against them.[132]

102. However the Debt Managers Standards Association (DEMSA), an industry trade body representing 18 DMCs,[133] argued a lot had been done to improve standards:

> All our members are independently audited every year, and we have a schedule of other monitoring of their compliance, which includes quarterly web sweeps and desktop analysis of all advertising, and a consumer satisfaction survey where we aim to sample 10% of the total consumer base held by our members; that is done on a monthly basis. We have mystery shopping: we employ independent mystery shoppers to shop at the companies. We have a complaints-handling procedure and we have a beefed-up compliance and disciplinary panel under the chairmanship of [...] a retired High Court judge.[134]

We remain to be convinced.

Fees

103. We questioned the industry on their charges—what they were on average and what they were spent on. Richard Wharton from DEMSA, said that there was an initial up-front fee, usually between one and two months' cost of the initial disposable income, and then there was an ongoing management fee, of around 15% to 17.5% per month of the monthly payments. Chris Davis from MoneyPlus Group explained that for that price, DMCs would distribute payments to creditors and negotiate with creditors to try and freeze interest and stop the late payment charges.[135] Furthermore, Mr Davis explained that consolidating a consumer's debts was not a straightforward process:

> We are seeing that our average consumer has seven debts. They may well be in arrears and in default with every single one of those creditors, so they will be getting letters, telephone calls, text messages and potentially visits. Our aim is to try and take

131 Q 206

132 Qq206 and 207

133 DEMSA website: Members http://www.demsa.co.uk/members/

134 Q 135

135 Q 127

> the stress and pressure off the consumer's shoulders, and I think it is very difficult to actually put a value on that.[136]

104. While Consumer Credit Counselling Service (CCCS) acknowledged that DMCs provided a valid service, it highlighted the fact that clients of fee chargers paid more under commercial debt management plans (DMPs) and therefore took longer to pay down their debts.[137] CCCS gave the example that for a debt of £30,000, a client of a typical DMC would pay almost £6,000 extra in fees; over and above loan repayments. This would extend the plan by approximately 18 months compared with a CCCS DMP, which was free.[138] Joanna Elson from the Money Advice Trust explained concerns:

> We—and, I am sure, the other advice providers here—have people coming to us who have tried to put things right, responded to one of these adverts and winded up in a worse situation than when they started.[139]

105. Which?'s worry was that DMCs were 'front loading' fees which could lead to mis-selling. It explained that because fees were front-loaded, the DMCs recouped a large chunk of money in the first few months of the DMP thereby still making a substantial profit from borrowers even if the plan failed. For example a DMC might set monthly repayments at a higher level than a borrower could afford thereby maximising its own gains and increasing the risk of the repayment plan failing. If the plan failed the DMC could then charge the borrower for moving them onto an IVA.[140]

106. We asked the Minister if he was concerned by the fee charging companies and he told us:

> There is some evidence that there is some abuse of upfront fees. However, we should not totally dismiss the paid for sector. They have a role to play.[141]

He believed that further regulation was not needed, that the OFT's guidance and enforcement regime was handling the industry appropriately, and that the OFT's approach was "the best way to drive out the people who are abusing upfront fees".[142]

107. **While we acknowledge that the OFT has provided guidance on up-front fees we do not believe that the Minister's assertion that such guidance will drive out the abuse of such fees goes far enough. We recommend the phasing out of up-front fees and look to the Department to set out how this will be brought forward.**

136 Q 128

137 Ev 86

138 Ev 86

139 Q 28

140 Ev 171

141 Q 252

142 Q 256

Transparency

108. Dr Gathergood, an economist from the University of Nottingham, explained that part of the problem with DMCs was a lack of transparency in the industry:

> Competition will be effective only if consumers have some basis on which to choose between competing firms. The absence of that information makes it very difficult for consumers to make a choice. The single, simplest, lowest cost thing that the private sector debt management industry could do is publish more data on the quality of its products and the outcome for consumers who take up their schemes.[143]

109. Dr Gathergood contrasted the requirement for lenders to advertise the APR of their products with the absence of any equivalent requirement for DMCs to provide information on their costs. He argued that "if consumers could see some kind of statistic on that, they might have some idea as to whether it is worth paying for the product".[144] The OFT agreed that more transparency was needed:

> I think the key thing is that the individual consumer should be able to see what they are paying and what they are getting for it, and should be able to compare what they are getting from one company to another.[145]

110. **We conclude that greater transparency in the commercial debt advice market, including a requirement that companies publish figures on the cost of their debt advice and their outcomes, would benefit the consumer and benefit the market. Such information could lead to a comparison website to help consumers chose whether a commercial debt management company is worth paying for as opposed to going to a free debt adviser. We recommend that the Government consider this in its discussions with the industry and introduce the necessary regulations if this is not achieved through voluntary agreements.**

Voluntary codes of practice

111. One of the solutions proposed by Government to improve the industry has been for a stronger industry code of practice—a 'debt management protocol'. However, that was not seen as a credible solution by Citizens Advice:

> The solution proposed is to develop a self regulatory protocol, just focusing on the debt management area. There are nearly 4,000 people with licences to undertake debt management at the moment, and only 17 are in the leading self regulatory membership body, so it is hardly going to touch the sides in that market.[146]

112. Delroy Corinaldi from Consumer Credit Counselling Service (CCCS) was concerned by the lack of sanctions against those that broke the codes:

143 Q 33

144 Q 26

145 Q 211

146 Q 53

> It was only last week or the week before that one of [the trade associations] identified a fee charger that is masquerading as a free-to-client debt adviser, and what they then did, which they saw as a success, was to make it public that they had actually put a fine against them and were trying to clean up their act. Well, who is the firm? They did not identify it. How much money did they make out of clients while they were masquerading as a free-to-client provider? They did not state that. I think there is a lot more that can be done. [...] It is quite likely that they are still walking around with an OFT logo on their website saying that they are OFT approved. A lot more needs to be done to clean up this sector, and it needs to be done pretty soon.[147]

113. Payplan supported these views and argued that:

> Our view is that trade body activities have been useful, but we need to go further. We need to have a truly vigorous, independent audit of debt management providers, not just to check they have been through all the processes and mentioned all the pros and cons, but to ensure that that advice is truly balanced. I do not think we are there yet.[148]

114. **We are sceptical of voluntary codes of practice in the debt management industry given the absence of proper sanctions against companies which either do not abide by the Code or are not members of trade associations. If self regulation is to be credible, the Government's proposals for a strong code will need to deliver effective enforcement, address the problems of excessive management fees and provide a simple mechanism for comparing paid-for advice and the availability of alternative free debt advice. These issues need urgent attention and we recommend that in its response, the Government sets out the detailed timetable for reform, how these issues will be addressed and when the new, strengthened code will be introduced.**

Client Accounts

115. DEMSA has acknowledged that there is more work for the industry to do on one specific area – that of client accounts. Richard Warton DEMSA's Director told us:

> I think there is one area where I would perhaps agree further emphasis needs to be put, and that is actually the protection of clients' account moneys held by companies. In DEMSA, we insist on a certificate from the company's auditors every year to certify that the clients' accounts have been handled in a proper manner.[149]

116. However, there was disagreement within the industry on how this should be done. Another industry trade association, the Debt Resolution Forum (DRF) representing 28 DMCs,[150] described DESMA's audit as "inadequate" and stated that it had made representations to the OFT on this matter. The DRF highlighted the insolvencies of two companies, Debt Doctor and Apex as examples of where "a more stringent audit of the client account" would have given an early alert to problems which would have averted "the

147 Q 53

148 Q 134

149 Q 135

150 DRF website Members List: http://www.debtresolutionforum.org.uk/members.php

very large amounts of money that have been lost by clients”.[151] Melanie Taylor from Gregory Pennington, a DMC, went further and argued for compulsory insurance to cover funds that are in the client accounts.[152]

117. **Effective auditing of Debt Management Companies’ client accounts should be established as a matter of urgency. We recommend that the Government include this in any discussion it has about the industrys’ proposals for self regulation, together with the establishment of an industry guarantee fund to protect the consumer in the event of company failure or fraud.**

Internet searches

118. The proliferation of DMCs on web searches at the cost of free debt advice was highlighted to us. CCCS said:

> If you go to Google, for example, and put in “National Debtline”, you will be swamped by fee chargers who are trying to get in on that sector.[153]

119. In the backbench debate in the House in December 2011, Yvonne Fovargue MP also brought up this point

> We need to look at Google. When someone googles “citizens advice debt advice”, they get the debt management companies, not Citizens Advice, because those companies can afford to pay for the ranking.[154]

120. Martin Lewis suggested how this could be dealt with so that consumers could recognise the difference between the bodies advertising and what they were providing:

> It seems to me you could have different categories and different stamps that you could call yourself. When some companies say they are free but then charge fortunes on the back end, they are free at the point of delivery only. A little bit of categorised regulation that says you have to use the right terminology would be very useful, and not particularly expensive to do.[155]

121. We questioned the Minister on what could be done and he recognised that internet searches “can create some real problems.” He hoped that “search engines would exercise some corporate social responsibility in this area”.[156] The Minister informed us that the OFT had looked at all forms of social media over the summer and had revised its guidance on advertising in the industry. The guidance now states:

> Licensees who advertise or sell online or by email must comply with the Electronic Commerce Directive, and before using internet-based and social media marketing,

151 Q 136

152 Q 136

153 Q 53

154 HC Deb, 1 December, col 1158

155 Q 53

156 Q 274

> licensees should consider whether they can exercise adequate control over its content. The OFT considers that search engine sponsored links and online messaging forums which limit the number of characters are unlikely to be an appropriate means of providing balanced and adequate information.[157]

He also said that Citizens Advice was now working with Google on the matter.[158]

122. It was reported that the Government is considering action to enforce where products are listed on internet search engines in another sphere—that of internet piracy. The government wants search engines such as Google to push unlawful sites down search result listings.[159] If the Government is prepared to take action in this arena, it should seriously consider doing so also with debt advice.

123. **We do not believe the Minister's reliance on internet search providers 'corporate social responsibility' to provide an adequate solution to the problem of commercial debt management companies dominating searches for debt advice to the detriment of free debt advice services. The Government must act on this now so that free debt advice is clearly shown as an available option for debt advice. In this respect, we encourage the Government to consider the feasibility of a traffic light system which would help consumers recognise more trustworthy sources of information.**

157 Q 274

158 Q 274

159 Computer Weekly: Jeremy Hunt calls on Google to downgrade piracy website search return listings

5 Government provision of debt advice: the Money Advice Service

124. The Government published its response to the personal insolvency part of its consultation on *Managing Borrowing and Dealing with Debt* in July 2011. In the response the Government announced that the Money Advice Service (MAS) had agreed to take on responsibility for the coordination of debt advice services in the future.[160]

125. MAS is a nationwide service that helps consumers understand financial matters and to manage their money better. Its statutory function is to:

> Enhance the understanding and knowledge of members of the public about financial matters (including the UK financial system), and their ability to manage their own financial affairs. This includes providing information and advice to members of the public to help them understand money matters better and take control of their money.[161]

It was set up by Government under the Financial Services Act 2010 and was temporarily known as the Consumer Financial Education Body, until June 2011 when it was renamed and launched as the Money Advice Service.[162]

126. MAS told us that its new role in debt advice was two-fold:

- To develop a model of debt advice delivery that is as efficient and effective as possible; and
- To ensure continuity of service delivery during a transitional period while the delivery model is developed and implemented.[163]

However, when we asked what exactly it added to the debt advice landscape, we were given the following suggestions by MAS executives:

> [MAS would] provide that objective overview and help work with those who do provide debt advice, including Citizens Advice, to come up with a more sustainable long-term model, including the funding for that.[164]

> Our project is to develop a model of debt advice co-ordination that will be sustainable and build on the good practice that already exists[165]

160 Consumer credit and personal insolvency review: summary of responses on consumer credit and formal response on personal insolvency, HM Treasury, July 2011, para 5.35, p 23

161 Consumer credit and personal insolvency review: summary of responses on consumer credit and formal response on personal insolvency BIS and HM Treasury

162 Consumer credit and personal insolvency review: summary of responses on consumer credit and formal response on personal insolvency BIS and HM Treasury

163 Ev 127

164 Q 144

165 Q 145

> There should be a single set of agreed outcomes for debt advice[166]
>
> There should be an effective triage process, where consumers can come in and be directed to the right sort of debt advice, and that should be multi-channel[167]
>
> There should also be a set of approved tools, so that the providers give consistent outcomes and there is an effective way of measuring that.[168]

127. While all of these aims are laudable we remain unclear on exactly what the role of MAS will be. Without its business plan or future budget—which are currently under consultation within the FSA—it is hard for us to gain a clear picture of what MAS will be doing within the next few years. When we pushed the Minister on this point, he told us that the role of MAS was to:

> Make sure that the branding of free publicly funded and supported debt advice is strong and well known. As I said in the House last Thursday, the Citizens Advice brand is very strong, very trusted and is something we should build on.[169]

We asked whether MAS would be coordinating advice or providing advice and Tony Hobman, Chief Executive of MAS told us it was "already providing advice across the web, telephone and face to face" but would also provide a co-ordinating role across the sector.[170]

128. We highlighted to Mr Hobman that there was already a lack of clarity in the debt advice landscape over who the providers were—which MAS could be adding to—and that both co-ordinating and providing debt advice could present further problems. However he replied:

> We absolutely do not want to add to the fragmentation and confusion that exists currently, so we will be working with all the stakeholders in the debt advice space to ensure this is not an issue, and that it ends being greater than the sum of the parts.[171]

Mr Hobman was at pains to reassure us that this was not setting up MAS in competition with Citizens Advice:

> The brand that we are building we say is not competing, because it is a generic advice space. We are trying to help all of those who are in the debt advice space to channel their business more effectively.[172]

129. We are unclear how MAS can brand build as a debt adviser but not compete with debt advice brands already out there such as Citizens Advice; and how it can co-ordinate debt advice without bias in 'channelling' and 'triaging' when it will also provide debt advice itself.

166 Q 145

167 Q 145

168 Q 145

169 Q 253

170 Q 147

171 Q 148

172 Q 150

130. **Without sight of the Money Advice Service's business plan it is difficult to accurately assess the impact of the Service and how it will operate. This is particularly worrying given the fact that it will be up and running by April of this year. At present, it appears to have a confused remit and one which overlaps with existing and highly respected brands like Citizens Advice. We do not believe that the Money Advice Service should enter into competition with Citizens Advice. It would better serve the public by supporting and promoting Citizens Advice.**

Face-to-face and web-based advice

131. The Government response to the consumer credit review recognised the continued need for free to consumer debt advice:

> What has become abundantly clear from responses to questions on personal insolvency is the importance of ensuring that consumers have access to free and impartial advice on dealing with their debts. We are told that this is crucial to their finding the most appropriate debt remedy for their circumstances.[173]

When he came before us, the Minister repeated his commitment:

> What I want to make sure of is that, for those consumers who cannot afford to pay, there is quality free-to-debtor advice available in different forms, and that people know that is available.[174]
>
> I put a huge value on face-to-face advice. I do not believe there should be any diminution of face-to-face advice.[175]

132. However during the course of the inquiry we became aware that MAS seems to have been tasked with moving people away from face-to-face advice to web-based advice. Tony Hobman, Chief Executive of MAS told us:

> There is a case for a substantial rebalancing. I understand that something like only 150,000 people of those millions that we talked about are currently using any form of internet based help. That instinctively feels far too low.[176]

This was supported by Lesley Robinson, Director of MAS Corporate Services who said that MAS was "currently looking at, the need point as opposed to the want point".[177]

133. Martin Lewis was not happy with this direction of MAS:

> The Money Advice Service is a good concept, but I think there needs to be some focus. It has unique properties to do things that nobody else can do, and I slightly worry that it is not focusing on what it can do uniquely; it is trying to brand build in

173 Consumer credit and personal insolvency review: summary of responses on consumer credit and formal response on personal insolvency BIS and HM Treasury, p. 4

174 Q 259

175 Q 266

176 Q 153

177 Q 153

> areas where it is not necessary. I have spent two years keeping my mouth shut on this, and today is the first day I have said it, because I think we have got to that point.

He argued that MAS was trying to build a money advice website yet there were many already out there, including his own:

> I have had so many e-mails from people who work in the organisation saying that it is trying to brand build and build a big website, if I am going to be absolutely frank and honest with you. Personally, I do not see the point.
>
> [...] We have 10 million users a month; I email 6.7 million people per week. thisismoney is big; lovemoney is big; Which? is pretty big. We all do a good job. You might say that we do some things you do not like, in which case, come and tell us and we will try to improve it. But why are we spending public money competing with that?

134. Martin Lewis believed that MAS should move away from web-advice and concentrate on financial education and helping vulnerable people through face-to-face and telephone advice.[178] MAS highlighted as an argument in favour of its web based work that 300,000 people had already visited its online financial 'health check' in 2011. However, as Martin Lewis pointed out his website moneysaver.com has 10 million visitors a month.

Legal aid budget

135. The effects of the reduction in the legal aid budget could be compounded if MAS concentrated more attention on web-based activity and away from face-to face meetings. Citizens Advice informed us that the legal aid budget for debt advice in England and Wales is due to fall by 75 per cent from 2013 and as a result figures, from the Justice Department, suggest that the number of people currently helped with debt problems will fall by 105,000. Theresa Perchard of Citizens Advice explained:

> At the moment it is difficult to say what capability the Citizens Advice Bureau service will have to deliver debt advice in two years' time. [...] With the reduction in legal aid funding for specialist debt advice, [...] we face rising demand and reduced resources.[179]

Commenting on this issue, the Money Advice Trust said that:

> Changes to legal aid provision mean [it] will not be available to those in debt, except where repossession is imminent. We expect this to start to have an impact on the variety of sources to which we can refer clients in need of specialist legal support.[180]

136. The Minister recognised the cuts to legal aid could be a problem:

> Clearly for particularly some Citizens Advice Bureaux and other advice agencies, it may well have quite a big impact. [...] I take the point, and I am afraid these are not

178 Q 153

179 Q 55

180 Ev 131

> easy times. There are cuts being made. What I am keen to do, and one of the reasons why we have now got the levy and the landscape review, is to make sure we are using the scarce resources as efficiently and effectively as possible.[181]

137. **We are confused by the Minister's assertion that there will be no diminution of face-to-face debt advice when the legal aid budget for debt advice is being cut by 75% and the Government appointed debt advice coordinator, the Money Advice Service, is advocating moving people away from face-to-face advice provision to web-based help. Web-based advice is better provided by existing free providers—for example Citizens' Advice or moneysavingexpert.com—both of which have high levels of brand awareness. We believe that Government funds would be better directed at highlighting and supporting those services, leaving the MAS to concentrate on telephone and face-to-face support.**

Funding

138. MAS is funded by a levy on financial services companies regulated by the Financial Services Authority. This levy will raise £27 million a year and will be used to replace Government funding of face-to-face debt advice from next year onwards. MAS was aware that raising money this way ran the risk of impacting on the funding of the fair share model. However, Lesley Robinson, Director of MAS Corporate Services was confident that this would not happen:

> It is not in any sense replacement or duplication, which I think is a key point. We believe that approach will complement, if you like, the work done by those providers funded by Fair Share, like CCCS and Payplan.[182]

139. However, there is a danger that if the industry is already having to pay for debt advice through the £27 million to MAS, it may start to reconsider its funding through the Fair Share Model to CCCS and Payplan. Again, Lesley Robinson gave us the following reassurance:

> We have obviously been in consultation with existing stakeholders, including the large financial services. They are fully aware of what we are doing and are supportive of it. They do not see funding the two as an issue.[183]

140. **The future funding of the Money Advice Service through an industry levy will reduce government expenditure, but it runs the risk that industry may be unwilling to fund both the Money Advice Service alongside its existing financial support for the fair share model. The Government needs to be alert to any withdrawal of financial support for the fair share model.**

181 Q 270

182 Q 158

183 Q 160

Salary of the Chief Executive

141. During this inquiry we were informed that the salary of the Chief Executive, including bonuses, was worth approximately £350,000. When he came before us Tony Hobman explained that he received £250,000 per annum, with "some benefits beyond that."[184] When pushed whether it was appropriate for a relatively small organisation, he said that it would make him "hugely incentivised" to do well.

142. We also questioned the Minister who said:

> It has not been a decision from BIS. As you will know, the budgets for MAS are set by the FSA and they are responsible to the Treasury via the FSA. We are just consulted on their budgets. But you will know, from evidence the Secretary of State has given to this Committee, that in BIS we are concerned about high salary levels, both in the public and private sector, and we would urge restraint at that sort of level, for sure. [...] I was not involved in the setting of it. All I will say is that it is quite a high amount, and I am sure the Financial Services Authority and the financial services industry will be wanting to look at it.[185]

143. **We are concerned by the high salary of the chief executive of the Money Advice Service. At a time of pay restraint we do not believe that the head of a comparatively small organisation should receive a salary £100,000 in excess of the Prime Minister. We look to the Government to raise this with the FSA as a priority. The perception of such extravagance does not sit easily in an organisation tasked with helping those in debt.**

184 Q 173

185 Q 219

Conclusions and recommendations

Regulation of Consumer Debt

1. The consultation closed on 21 March 2011. The Treasury Committee said in January 2012 "[we] are disappointed that 7 months after the consultation closed, the Government has yet to make up its mind". We are concerned that the introduction of the Financial Services Bill has changed nothing by announcing the need for further consideration. In the meantime consumers and the industry are left without clarity on how the consumer credit market is to be regulated in future. We expect the Government—within six months—to outline a timetable and methodology for how and when a decision will be made on whether the power to transfer consumer credit from the OFT to the FCA is to be exercised. (Paragraph 10)

2. It is clear that improvements should be made to the regulation of the debt and credit industry. The Government's review of consumer credit regulation should be seen as an opportunity to address the many current shortcomings. In framing its new approach we recommend that the Government put in place the following reforms:

   - That higher licensing fees should be charged for higher-risk credit businesses to allow for greater levels of assessment of competence and fitness to operate.
   - That a fast-track procedure be developed to suspend credit licences; and
   - That the regulator be given the power to ban harmful products. (Paragraph 29)

3. We welcome the Government's proposals for Christmas campaigns on debt amongst young people and illegal money lending. That said, we do not believe that the timing of these campaigns—which only started in December—gave sufficient time to gain traction with the public and we recommend that future campaigns start in October. We further recommend that the Government, in its response, sets out the measurable impact on consumers of last year's campaign. (Paragraph 31)

Payday Loans

4. We were pleased to hear that the OFT will be carrying out a compliance review of payday loan companies early in this year. In view of the rapid proliferation of payday loan companies, the Government will need to act swiftly to counter any evidence of non-compliance reported in the OFT's review. (Paragraph 44)

5. The evidence we heard has left us in no doubt that the Government must act to limit the rolling over of loans in its review of this sector. (Paragraph 48)

6. We do not see the need for Government to commission research, with all the associated costs, from the University of Bristol on the capping of total credit costs given the amount of evidence and research available on the Canadian and US market. If Government continues to believe that new research is necessary, it will need to set out which specific areas lack existing data. (Paragraph 52)

7. It is clear that credit checking is a key factor in ensuring appropriate lending to consumers. We are therefore deeply concerned with the evidence that payday providers are not recording all of their transactions. Examples of credit databases that do capture payday lending are available in other countries and we recommend that the Government require industry to introduce similar models in the UK as a matter of urgency. (Paragraph 58)

8. In addition we further recommend that payday lenders be required by law to record all loan transactions on such a database so that consumers' credit histories can be accurately monitored. We further recommend that the Government explores how this mechanism can be used to limit the practice of switching between payday loan companies and the subsequent rolling over of loans. (Paragraph 59)

9. We recommend that the Government studies the Florida example to see what lessons can be learned for the UK market on successful regulating of the payday loans market. (Paragraph 64)

10. Whilst we recognise that although the use of continuous payment authority is legal in the payday loans market its use must be carefully monitored. We welcome the OFT's consultation on this matter and recommend that clear rules be put in place to outlaw companies accessing funds without prior agreement. We further recommend that the Government make clear to payday loan companies that if they do not demonstrate a commitment to moving away from the continuous payment authority as the method for receiving payments, the new regulator will be asked to address this matter as a priority. (Paragraph 67)

11. For self regulation to be effective it has to include transparent and enforceable sanctions. We understand that more vigorous codes of practice are under development by the industry. The Government must ensure that self regulation can deliver the necessary enforcement sanctions and demonstrate that they are sufficient to protect consumer interests. Therefore, we recommend that the Government provide us with an update on the development of the codes of practice by the end of 2012. If it cannot be demonstrated that self regulation can deliver the necessary protections then the Government will need to intervene with statutory regulation. (Paragraph 73)

12. We recommend that APR should no longer be used to measure and compare the cost of payday loans. Instead, the total cost of the loan should be made clear; for example if £100 is borrowed and £150 is paid back including interest and fees then this total amount is the figure that should be advertised. It also should include how much it costs if paid back a week late, 2 weeks late and so on, so consumers are clear of the reality and penalties of late payment. (Paragraph 79)

Credit Unions

13. Credit Unions have a valuable role to play in this market and their role needs to be highlighted by Government. We support the argument that the Post Office network has huge potential to work with the Credit Unions to provide short-term loans at a lower cost than commercial pay day lenders. We recommend that the Government

set out in its response, how it proposes to use Post Offices as a vehicle to expand the Credit Union market. (Paragraph 88)

Social Fund

14. We are concerned by anecdotal evidence which suggests that the removal of the Social Fund will push people towards payday and other high cost lenders. In its response to this Report, we will expect the Department to set out what meetings—at Ministerial and Official level—have already taken place on this issue; and to set out what joint plans Ministers from BIS and the DWP have put in place to ensure that the Social Fund and the proposed 'local welfare assistance' will protect the most vulnerable from payday and other high cost lenders or loan sharks. (Paragraph 95)

Debt Management Companies

15. While we acknowledge that the OFT has provided guidance on up-front fees we do not believe that the Minister's assertion that such guidance will drive out the abuse of such fees goes far enough. We recommend the phasing out of up-front fees and look to the Department to set out how this will be brought forward. (Paragraph 107)

16. We conclude that greater transparency in the commercial debt advice market, including a requirement that companies publish figures on the cost of their debt advice and their outcomes, would benefit the consumer and benefit the market. Such information could lead to a comparison website to help consumers chose whether a commercial debt management company is worth paying for as opposed to going to a free debt adviser. We recommend that the Government consider this in its discussions with the industry and introduce the necessary regulations if this is not achieved through voluntary agreements. (Paragraph 110)

17. We are sceptical of voluntary codes of practice in the debt management industry given the absence of proper sanctions against companies which either do not abide by the Code or are not members of trade associations. If self regulation is to be credible, the Government's proposals for a strong code will need to deliver effective enforcement, address the problems of excessive management fees and provide a simple mechanism for comparing paid-for advice and the availability of alternative free debt advice. These issues need urgent attention and we recommend that in its response, the Government sets out the detailed timetable for reform, how these issues will be addressed and when the new, strengthened code will be introduced. (Paragraph 114)

18. Effective auditing of Debt Management Companies' client accounts should be established as a matter of urgency. We recommend that the Government include this in any discussion it has about the industrys' proposals for self regulation, together with the establishment of an industry guarantee fund to protect the consumer in the event of company failure or fraud. (Paragraph 117)

19. We do not believe the Minister's reliance on internet search providers 'corporate social responsibility' to provide an adequate solution to the problem of commercial debt management companies dominating searches for debt advice to the detriment

of free debt advice services. The Government must act on this now so that free debt advice is clearly shown as an available option for debt advice. In this respect, we encourage the Government to consider the feasibility of a traffic light system which would help consumers recognise more trustworthy sources of information. (Paragraph 123)

Money Advice Service

20. Without sight of the Money Advice Service's business plan it is difficult to accurately assess the impact of the Service and how it will operate. This is particularly worrying given the fact that it will be up and running by April of this year. At present, it appears to have a confused remit and one which overlaps with existing and highly respected brands like Citizens Advice. We do not believe that the Money Advice Service should enter into competition with Citizens Advice. It would better serve the public by supporting and promoting Citizens Advice. (Paragraph 130)

21. We are confused by the Minister's assertion that there will be no diminution of face-to-face debt advice when the legal aid budget for debt advice is being cut by 75% and the Government appointed debt advice coordinator, the Money Advice Service, is advocating moving people away from face-to-face advice provision to web-based help. Web-based advice is better provided by existing free providers—for example Citizens' Advice or moneysavingexpert.com—both of which have high levels of brand awareness. We believe that Government funds would be better directed at highlighting and supporting those services, leaving the MAS to concentrate on telephone and face-to-face support. (Paragraph 137)

22. The future funding of the Money Advice Service through an industry levy will reduce government expenditure, but it runs the risk that industry may be unwilling to fund both the Money Advice Service alongside its existing financial support for the fair share model. The Government needs to be alert to any withdrawal of financial support for the fair share model. (Paragraph 140)

23. We are concerned by the high salary of the chief executive of the Money Advice Service. At a time of pay restraint we do not believe that the head of a comparatively small organisation should receive a salary £100,000 in excess of the Prime Minister. We look to the Government to raise this with the FSA as a priority. The perception of such extravagance does not sit easily in an organisation tasked with helping those in debt. (Paragraph 143)

Formal Minutes

Tuesday 21 February 2012

Members present:

Mr Adrian Bailey, in the Chair

Mr Brian Binley	Simon Kirby
Paul Blomfield	Ann McKechin
Katy Clark	Mr David Ward
Rebecca Harris	Nadhim Zahawi

Draft Report (*Debt Management*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 143 read and agreed to.

Resolved, That the Report be the Fourteenth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report

[Adjourned till Tuesday 28 February at 10.00 am

Witnesses

Tuesday 22 November 2011

Page

Tuesday 29 November 2011

Tuesday 13 December 2011

List of printed written evidence

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2010–12

First Report	The New Local Enterprise Partnerships: An Initial Assessment	HC 434 (HC 809)
Second Report	Sheffield Forgemasters	HC 484 (HC 843)
Third Report	Government Assistance to Industry	HC 561
Fourth Report / First Joint Report	Scrutiny of Arms Export Controls (2011): UK Strategic Export Controls Annual Report 2009, Quarterly Reports for 2010, licensing policy and review of export control legislation	HC 686
Fifth Report	Government Assistance to Industry: Government Response to the Committee's Third Report of Session 2010–11	HC 1038
Sixth Report	Is Kraft working for Cadbury?	HC 871
Seventh Report	Rebalancing the Economy: Trade and Investment	HC 735 (HC 1545)
Eighth Report	Trade and Investment: China	HC 1421 (HC 1568)
Ninth Report	Time to bring on the referee? The Government's proposed Adjudicator for the Groceries Code	HC 1224-I
Tenth Report	Pub Companies	HC 1369-i *(Cm 8222)*
Eleventh Report	Time to bring on the referee? The Government's proposed Adjudicator for the Groceries Code: Government Response to the Committee's Ninth Report of Session 201-12	HC 1546
Twelfth Report	Government reform of Higher Education	HC 885-I/II/III
Thirteenth Report	Pre-Appointment Hearing: Appointment of Director of the Office for Fair Access	HC 1811

Oral evidence

Taken before the Business, Innovation and Skills Committee

on Tuesday 22 November 2011

Members present

Mr Adrian Bailey (Chair)

Paul Blomfield
Julie Elliott
Rebecca Harris
Margot James
Simon Kirby
Ann McKechin
Nadhim Zahawi

Examination of Witnesses

Witnesses: **Joanna Elson**, Chief Executive, Money Advice Trust, **Professor Iain Ramsay**, University of Kent, and **Dr John Gathergood**, University of Nottingham, gave evidence.

Q1 Chair: Good morning and welcome to this morning's session. Can I thank you for agreeing to come before us today? Just before we start, could I ask you to introduce yourselves? I know you need no introduction, but it just helps for recording and voice transcription purposes. If we start with you, Dr Gathergood.

Dr Gathergood: I am John Gathergood, I am a lecturer in economics at the University of Nottingham.

Joanna Elson: I am Joanna Elson, I am Chief Executive of the Money Advice Trust.

Professor Ramsay: I am Iain Ramsay, I am a Professor of Law at the University of Kent.

Q2 Chair: Thanks very much. Just before we start, obviously some of the questions will be fairly general. There are three of you; I do not need each one of you to repeat the same message. Obviously, if somebody makes a point that you disagree with profoundly or you feel that there is need to add a further point to what has been said by another member of the panel, then feel free to do so, but in the interest of brevity, if you could avoid repeating yourselves. I will just start with a fairly general question: basically, what causes people to get into unmanageable debt?

Dr Gathergood: There are maybe three main explanations for unmanageable debt. In about 50% of cases, an individual moving into consumer credit arrears or payment problems has experienced some kind of individual level shock. One could think of unemployment, divorce, ill health or unexpected expenses. If you look at the histories of people with debt, about half of the people in debt problems have some recent event in the last couple of years such as those.

The second major cause is macroeconomic developments and shocks, so interest rate movements—which impact all households but most affect households that are highly leveraged and have large credit commitments—and aggregate movements in unemployment as well.

The third factor is what we might describe as individual imprudence. Some proportion of debt problems are inevitably explained by people over-borrowing due to a lack of self-control in their finances, maybe being illiterate financially and not understanding the true cost of credit; that would explain some proportion of observed debt problems.

Q3 Chair: Do either of the other two members wish to add to that?

Professor Ramsay: I would agree pretty much with those points. The study from 1989—in 2002 there was a replication of the study—showed that unemployment and other changes of circumstances in people's life situation were the primary causes. The Insolvency Service's data show that as well, as do the Consumer Credit Counselling Service's statistical data. In terms of imprudence, it is sometimes difficult to assign a definitive reason to why people get into serious over-indebtedness. For example, you lose your job and then you use credit cards to maintain yourself because you think events will get better. Do you code this as people being imprudent, or do you say it is life circumstances? It is often a combination of circumstances. We also have to remember, in terms of thinking historically, the extent to which since the early 1980s there has been an enormous growth in debt; I will not go into the reasons for that. To a certain extent, debt is being used to maintain consumer demand and maintain consumption status. There is a recent paper in the *Cambridge Journal of Economics* suggesting we have increasingly had a model of loans for wages over the past 20 years: two household incomes are necessary to maintain a middleclass lifestyle, so anything that happens in terms of losing a job means that you are going to have financial problems because of the high levels of debt.

Q4 Chair: Thank you. Going back to your response, Dr Gathergood, could you give us any sort of statistical proportion—I appreciate it is only a very broad estimate—of how many would fall into each category or what percentage would fall into each category?

Dr Gathergood: I mentioned that maybe half of individual debt problems could be explained by a change in individual circumstances and among those kinds of transitions, such as unemployment, divorce and ill health, unemployment or a drop in wages is the largest component. I cannot offhand give you more detailed statistics on the proportions of each, but I could supply those subsequently from various econometric studies, if that is useful.

Q5 Chair: You have loosely described one category as financial imprudence. Could you give an estimate of the element of financial imprudence that is just a lack of judgment, and the element that is just financial illiteracy and people not understanding?
Dr Gathergood: Academic studies in economics literature attempt to measure individual traits and behaviour, such as having a self-control problem or not understanding aspects of finance such as interest compounding or what "minimum payment" means on a credit card. These studies typically find that maybe between 5% and 10% of the population exhibit self-control problems in their expenditures. Given that about 40% of the population at any one time has outstanding consumer debt that is being revolved month-on-month, some form of financial imprudence, in terms of lack of self-control, might be prevalent in one-quarter of those. The statistics on financial illiteracy tend to be stronger, so it is true to say that across the board consumer credit users typically have poorer levels of financial literacy than those with investments and net saving behaviour. Relating that kind of measure to specific outcomes is more difficult because it tends to be very individual and specific, depending on the type of credit that someone is using.

Q6 Chair: Has it got worse recently?
Joanna Elson: Yes, it has got worse recently. We commissioned Dr Gathergood to do some work on this for us, looking at the figures through the downturn, and also looking forward. He collected for us statistics looking at the four major providers of free debt advice—Citizens Advice, the Consumer Credit Counselling Service, Payplan and National Debtline, which we ourselves run. The number of people seeking advice during that period went up from between 1 million and 1.2 million before the downturn to about 1.5 million. The figures have slightly stabilised since then: they are at about 1.3 million now and have stayed at that rate for about two years. There are fairly significant levels of demand still.

Q7 Chair: There is a correlation between the macroeconomic situation and the levels of personal indebtedness and problems arising from it; is that a reasonable observation to make?
Professor Ramsay: I can simply make the observation perhaps in relation to insolvency, which is obviously the ultimate remedy, and other forms of composition of debt. It is true that the level of individual insolvency has increased in the UK, but the UK level is still significantly lower than that in a country such as Canada or the United States. It is about the same as in Australia and slightly higher than in France or Germany. I would not say "correlation", but there is a rough relationship between level of outstanding household debt and levels of insolvency. All other things being equal, the more debt a country has, the more insolvency; in other words it's an inevitable aspect of household credit and debt.
Dr Gathergood: It's also worth noting that personal insolvencies began to arise more dramatically before the onset of the credit crunch and the recession. It was 2005–2006 when there was a large increase in bankruptcy filings and awards of IVAs. To some extent, I think the consumer credit crisis, the problems that we experience today, predated the more general recession in the economy.

Q8 Chair: That is interesting, but has it got worse since the recession in 2008?
Dr Gathergood: Yes, since 2008–2009, the personal insolvency rate has increased by 30%, as has the number of individuals seeking advice about their debts. The amount of credit written off by lenders has also increased by around 1 percentage point from 1.5% to 2.5% of outstanding debt since the first quarter of 2008.

Q9 Chair: So it was becoming a problem before the actual recession, and that obviously has aggravated an underlying problem that was emerging. That has partly answered my next question, which was: what problems are due to socio-economic factors and trends? Is there anything you wish to add about the social and economic trends taking place and how they have been impacted on by the recession, over and above what has been said already?
Dr Gathergood: It is worth drawing a distinction between two main socio-economic groups who struggle with debt problems. There are low-income households who struggle to meet their everyday or necessary expenditures and use credit as a means of sustaining a minimum level of consumption; they are perpetually in debt. There is also a large group of middle-income households, often young families, who have taken out debt on the expectation of income growth, so that the mortgage and consumer credit decision is made in part in expectation of promotion and real wage increases and such like. Particularly in the current recession, those households have been particularly vulnerable because, as unemployment rises and real earnings growth is very weak, they are not seeing the increases in household income that they had expected. So the debts that they took on in anticipation of income growth are now becoming a larger burden.
Joanna Elson: Our services are seeing across the board that debt is no respecter of social class. At National Debtline now, we have as many people calling us who have an income of £30,000 or above as those who have an income of less than £30,000. That is a change since the downturn.

Q10 Nadhim Zahawi: Just following on from that question about trends, what trends are you seeing in terms of overall household debt over decades, for example?
Joanna Elson: Do you mean in terms of proportions of debt?
Nadhim Zahawi: Precisely.
Joanna Elson: We have had relatively stable proportions of debt for a number of years. Things like bank loans, overdrafts and credit cards come fairly high up there. One that is coming up as a trend, and has been for the last two or three years, is utility debts, perhaps not surprisingly. Government debt is also up

there; 36% of people who have called our services have a debt to the Government in one way or another, whether that is council tax, benefits overpayments or things like TV licences, Child Support Agency debts and so on. There is also an increase in high-cost credit, which I know you are interested in. We started collecting data on payday loans a year ago when they started to become an issue; we were getting 200 calls a month then, and it is over 1,000 calls a month now.

Dr Gathergood: Looking more generally, cross-country over long periods of time, there has been an accumulation of debt in most Western economies. Most of that is attributable to more sophisticated credit scoring, allowing higher risk consumers to access debt whereas previously they would not have had any access. As Iain mentioned, that partly explains the increase in the bankruptcy rate: you have more high-risk individuals with access to some credit, but because they are higher risk they are more likely to get into debt problems. There is about £200 billion worth of outstanding consumer credit in the UK economy. That is about 80% of household disposable income. Since the 2005–2006 period, when household debt problems seemed to increase, most households have been repaying their consumer credit balances, so the gross value of outstanding debt is declining and the real value—

Nadhim Zahawi:—has fallen, that is my point.

Dr Gathergood: Yes, it is declining more sharply. Whereas in 2005, total household debt was about 100% of household disposable income, it has now fallen to around 75%, which is similar to the level at the turn of the millennium. Although the nominal value of debt increases, in the same way that nominal GDP tends to increase even during periods of recession, relative to household income or to prices, the trend is actually for falling household indebtedness.

Q11 Nadhim Zahawi: Over the period of the downturn, since 2007–2008, is that fall accelerating?

Dr Gathergood: Yes, the fall is accelerating. In the broad sweep, most households with consumer credit are reducing their balances, but there is a concentration of households with debt problems, and that concentration is larger than it was previously.

Q12 Chair: So, broadly, those who can afford to pay off debts are doing so, presumably due to the uncertainty of the economic climate, but the number who actually cannot afford to sustain their debt is increasing.

Dr Gathergood: Yes.

Q13 Simon Kirby: Just a quick technical question: is the total level of debt the best indicator? Surely the interest on that debt is a more telling figure.

Dr Gathergood: There are various ways to look at the statistics: you could look at income gearing, the proportion of household income that is used to pay debts; the total interest burden of debt in terms of the gross value of payments to service outstanding loans; or the value of outstanding loans. The value of outstanding loans is a helpful measure because the debt, ultimately, has to be repaid. The interest-based measure—the interest payable on current debts—is more a measure of the flow of payments required to maintain a particular level of debt. I think if one were to look at alternative statistics, it would be more useful to think about the distribution across households, because 60% of households in the UK have no outstanding debts. Most households have access to debt, most obviously by credit card, but most credit card users pay their balances off before the interest-free period expires.

Q14 Chair: We are talking about unsecured debt; we are not talking about mortgages and so on.

Dr Gathergood: True. So something like 75% of households hold an unsecured debt product, most commonly a credit card. Only 40% of households have an outstanding balance that is accruing charges on a consumer credit product. That is across the broad range of different forms of unsecured credit. If you break it down across households, there is a wide distribution of levels and types of debt.

Q15 Chair: Just to clarify that, 40% of our population have outstanding balances they are not paying off that are actually accumulating. Have I interpreted that correctly?

Dr Gathergood: Yes; 40% of the population borrow on a credit product—as opposed to a credit card—that they pay off within 56 days, incurring no interest.

Q16 Nadhim Zahawi: I want to go back to the concentration of those who have unmanageable debt. Joanna referred to the number of calls from higher income groups. Can you shed some light on numbers—i.e. what is that percentage of higher income groups? What income levels are we talking about? You talked about £30,000 salaries at the higher end. Can we have some more hard data: within that concentration of people who are in unmanageable debt, what is the profiling in terms of incomes?

Joanna Elson: We can look at that and I can send it to you, but I have not got that off the top of my head. I do not know whether Iain might have some of that information.

Professor Ramsay: I can give you some very raw thoughts on insolvency. In the US, there is the idea that insolvency is a middle-class phenomenon. In the UK, it is very difficult to generalise because we do not have terribly good data, but bankrupts generally have a high level of unemployment and a low level of home ownership. Of those on debt relief orders, the Insolvency Service data show that 63% are female, 80% are not in employment and 45% are single. For those who do IVAs, which is the composition, again we do not have very good data, but the limited studies in the mid-2000s showed there were more homeowners. The majority are unskilled, semi-skilled and clerical categories—C and D—but they are in employment. Perhaps up to 33% own a home. The most recent data from the annual report of the Consumer Credit Counselling Service, show that the average annual gross income of a CCCS client is £22,000, which is £3,500 less than the UK average; 55% receive some type of tax credit or benefit. In general we are looking at lower-middle/lower-income and poor consumers who take the ultimate remedy, if you like: insolvency and debt repayment. That is not to say that more higher income people are not using these services, or that debt does not affect everyone, but one probably would say that, to the extent that people are using these safety nets, they are in these particular groups.

Q17 Nadhim Zahawi: One of your points was that 63% are female.
Professor Ramsay: That is on the debt relief order, which is essentially for people who are very poor.

Q18 Nadhim Zahawi: Is there any more gender profiling? Are we seeing a skew, as in two-thirds to one-third, in that case, for females?
Professor Ramsay: The Insolvency Service explains that by saying that women have lower levels of debt generally than men. I am not terribly aware of studies of gender in debt. I do know, although I have not looked at it recently, that the 2005 *Tackling Over-indebtedness Annual Report*, by the Task Force on Over-indebtedness, suggested that women were over-represented in all types of over-indebtedness indicators. I would have to go back to the report to look at the details, but you might want to follow that up. The Griffiths Commission in 2005 said debt disproportionally affected low-income families and lone parents, which would often be women. Unlike in the United States, where there have been some studies on bankruptcy and gender, I am not aware of much further analysis. I don't know if my colleagues are.
Joanna Elson: We did a little bit of work on advice-seeking behaviour in terms of gender, focusing on men because there had been some done on women before. That found that men were less likely to seek advice, which is just about borne out in our own statistics; they wanted to be in control and to look after things themselves; they had an over-optimistic view on the prospects for improvement, so they did not feel they had to seek advice; they wanted to have do-it-yourself types of remedy, which was just one of the reasons why we introduced an internet tool called My Money Steps. That is what we learned about men and advice-seeking behaviour.
Dr Gathergood: If you are interested in detailed breakdowns of level of debt and debt behaviours across income distribution, gender and household composition, it is quite feasible to put together a set of statistics for submission to the Committee.
Nadhim Zahawi: If you can, that would be very useful to the Committee.
Chair: Yes, please do.

Q19 Nadhim Zahawi: Is high-cost consumer credit—payday loans—exacerbating the situation or is it a valued resource for consumers?
Joanna Elson: I am not a person who generally seeks to ban things; there is some use in these products, and for some people in specific circumstances they can be helpful. There is a big health warning around that. I have mentioned the statistics we have on the rise in people having problems with payday loans. It is an area for me where I would not be looking to ban things, but I would be looking at whether the regulation around it is sufficient and whether people understand what they are getting into. For instance, with payday loans you will know there is a process where you can roll over the loan for a short period of time. Every time you roll it over, of course, you have an additional charge. That is where people get unstuck. They do not realise that, very quickly, they are into a big spiral. If they use it for the purpose that perhaps it was intended, which is a stop-gap, once, that is fine. If that is not understood, and it is used in the way that many people are now using it, it can definitely exacerbate things.
Dr Gathergood: Payday loans are expensive, relative to other forms of credit. They might not be expensive relative to other credit options for people who use them, for instance if the choice is between a payday loan and an unarranged overdraft. Payday loans are also available at very short notice, in some cases over the counter or bank transfers in 10 or 15 minutes. I would draw a contrast between two types of users of payday loans. For people who have had a financial shock and need money quickly to address that, who intend to repay, will be in a position to repay and need the money now, a payday loan can act as a high cost but effective form of insurance. For people who lack control in their expenditures and might take out debt in order to purchase something they want at short notice without an ability to repay, a payday loan is an opportunity for them to be a victim of their own behaviour. Payday lenders would obviously associate themselves with the former group, who need short-term credit and for whom it is welfare-improving, but in providing loans they are opening themselves up to a client base who might be more impulsive and make poor use of credit.
Professor Ramsay: I would generally agree with the comments that have been made. Payday loans are of course regulated under the Consumer Credit Act, so you will see their advertisements indicate that the APR for a payday loan is usually around 1,000%. However, people continue to use payday loans, which suggests that, as Joanna said, one needs some specific regulation of payday loans in terms of rollovers, whereby people are using them on a continuing basis. I was involved, in Canada, in writing a paper for the Government on payday loans when they were developed in the early 2000s. Canada now has regulation of the cost and these other aspects of payday loans. I think the regulation is necessary to protect against the type of borrower that Dr Gathergood was talking about who may be disadvantaged by using payday loans.

Q20 Nadhim Zahawi: We touched on the lack of financial education as a factor in people borrowing at extortionate percentage rates. You are at the coalface; how do you best tackle that? There are a lot of initiatives around, but we still have a gap. The reason why people go for things like payday loans at 1,000% or 2,500% is possibly because it is accessible, easy and they do not need to read a thousand pages of stuff.
Joanna Elson: I think that is right. Professor Elaine Kempson did some work in 2006 on levels of financial capability, and found them low, particularly among the under 40s. That study is going to be, in some sense,

repeated; I do not imagine very much will have changed since then. You are right; there is something we need to do. I am a big supporter of financial education in schools. I think that is the right place to start teaching children about money, but of course that is not the whole picture. People are not legally liable for a debt until they are 18, so, in some senses, until you experience things you do not really learn the lesson. However, I do think that schools are an important place to start.

Beyond that, I think it has to be about the touch points where people need advice and information, where they are likely to get the educative effect. For instance, we do an impact report on our services, and 86% of people who have been through our debt advice services say that they feel more financially confident, and more capable of dealing with their finances going forward. Looking at the free text, they say things like, "It was horrific. I didn't understand. I am not going to get in this mess again. Now I understand. I can do an income and expenditure; I know where to go." That is a powerful tool for rehabilitating and getting people back in control of their money. Our vision at the Money Advice Trust is about helping people both tackle their debts and manage their money wisely. I think the two have to go together.

Dr Gathergood: If will just add two brief points. On this issue of financial literacy, it is fair to say that most people in the population have some understanding of financial products, but sometimes not enough to make the right decision. If I could give an example, I think everyone knows that a lower APR means that a loan is cheaper compared to a higher APR, so one would naturally look for the loan with the lower APR. You may find a loan with an APR of 12%, and that is the cheapest you can get. What does a 12% APR mean? If you ask individuals, "Now you have that loan, what actual stream of payments does that involve?", it is difficult for people to make that calculation. One needs the literacy to identify the cheapest loan, which is quite straightforward—you look for the cheapest APR—but also the literacy to be able translate that, or for the lender to present it to you, in terms of a stream of payments over a period of time so you can then sit down and think, "Can I afford those payments?"

The most obvious point at which to identify individuals who lack literacy is when they make the loan application. If you are not going to borrow, if you do not have a borrowing need, you do not really need to know about consumer borrowing, but if you are at the point of application then it is in your interest, and it is commonly in the interest of the lender, for you to understand what this involves in terms of a stream of payments—pounds per week, per month, whatever the payment period is.

Professor Ramsay: Could I make a comment? Generally there is a lot of support for the idea of financial literacy and financial education. Obviously, one could not be against the idea of ensuring that people make the right decisions. But we do not know that much about the effect of financial education. For example, the World Bank in its *Good Practices in Consumer Protection in Financial Services* says that, "Improving financial literacy is a long-term process for which little is clearly understood as to what works (and what does not) in improving financial behaviour." A review of behavioural finance for the Financial Services Authority suggested it was not the absence of information but so-called behavioural biases that caused consumers to make repeated mistakes. It is sometimes difficult to change these behavioural biases. I think it is important to identify the so-called teachable moments, but even there it may be difficult. For example, in Canada, financial counselling was introduced as mandatory for all bankrupts, but it is still not clear whether that has had an impact. One study managed to look at a cohort who had not had counselling and a cohort who had had counselling over a long period of time, and had difficulty finding a difference in their subsequent financial behaviour. I think it is a good idea, but we need to be careful about it and assess it carefully. I do not think one could see it as a substitute for regulation.

Q21 Chair: That is an interesting observation. It is possible to construct an argument that somebody with greater self-confidence, as they say, in understanding finance might be more prone to taking risks than somebody who is not. Is there any evidence to substantiate that?

Professor Ramsay: I think there might be; I would have to go and check.

Dr Gathergood: As it happens, this is a topic I am doing some work on at the moment. I think what you have surmised is exactly correct. If one attempts to measure people's financial understanding and then asks them how confident they are in making financial choices, one finds that there is a subset of individuals who appear too confident relative to what they understand. That is associated with problem debt. I can provide some more detailed statistics, but that phenomenon is not uncommon.

Q22 Chair: I would like to go back to a previous question. Dr Gathergood pointed out that the payday loans market comprised two groups of people: those who had a specific expenditure item that they wished to pay off prior to payday, which they could clear through their pay, and those who were using the payday loan to subsidise a standard of living that would cause them to roll over the debt. Do you think that there is any point to, or potential benefit in, looking at the way payday loan companies advertise their product, to try and draw out this distinction and discourage the latter group of consumers?

Professor Ramsay: To a certain extent, that is already envisaged in the responsible lending guidelines of the Office of Fair Trading and the implementation of a European directive requiring creditors to explain the credit to a debtor. The guidelines suggest that, in explaining the credit to the debtor, one thing they should say is, "This is a short-term loan product that you should not be using on a continuing basis." So there already is that potential. The question is whether you want to have notices, for example, in stores, and how effective that would be.

Q23 Chair: The issue is advertising and attracting such people.

Professor Ramsay: In terms of having a disclosure at the bottom.

Chair: Yes.

Dr Gathergood: This is a tricky issue. Take the issue of how immediately the money is available; that might attract people who are impulsive and want to buy something quickly, but it might also be useful for people who have a short-term financing need and need the money quickly. It is not obvious that, if you make money available more quickly, you will necessarily get people who walk into loan shops, grab the money and go and spend it on something that they should not. The most obvious indication of whether a payday loan is being taken out to fund a necessary short-term expense or an unwise expense is what the money is spent on. Some payday lenders are able to identify that; others, most obviously those who deal in cash, are not.

Joanna Elson: There is quite an interesting suggestion in the ABCUL—Association of British Credit Unions Limited—submission to this Committee. Just as we have said that fee-charging debt management companies that advertise and deal with customers ought to tell people that there is a free alternative—a number of you have signed an EDM to that effect—the ABCUL idea is that those who advertise high-cost credit ought to say, "Actually there is an affordable alternative, which is a credit union." I do not know how well it would work and I do not know if any research has been done on that, but it is an interesting idea.

Q24 Margot James: Is there any advice for people coming at the debt issue from the other end of the telescope, if you like—rather than about how to deny yourself things and reign in, about how to get more for your budget. A lot of people, I think, come into this too late because they fear they do not know how to manage their situation; if they only knew what the possibilities were to get more for their spend they might be seeking advice earlier.

Joanna Elson: That is a very good point. You are hearing later on from a number of debt advice providers. All of them will be doing that. When somebody comes to a debt advice provider they will be looking at these kinds of things: can you increase your income, can you decrease your expenditure? Are you getting the best deal on your telecoms and utilities? What about your mortgage? Are you paying over the odds for that? Do you need that gym membership? Are you getting the tax credits and benefits to which you are entitled? We did a piece of qualitative research called *Facing the Squeeze* earlier this year, which looked at how 30 low-to-middle-income families were coping with the downturn. What that showed was that people were trying all kinds of things. These were fairly desperate measures for some of them: selling pets, bringing food home from work, and these kinds of things. What they were not doing was the thing that would have made the difference. The advice—it does not have to be face-to-face; it could be on the telephone or internet—will help you prioritise things and ensure you are making the right choices. People were not intuitively doing those things. So, yes, I completely agree with your question.

Q25 Rebecca Harris: Professor Ramsay has spoken a couple of times about the need for regulation in some areas. I wanted to bring the panel on to your views on the Government's response to the consultation on consumer credit and personal insolvency, which has very strong emphasis on a voluntary approach from the industry. I just wanted to hear your views on that, and whether you think the Government have got the balance right.

Joanna Elson: It is often wise to start with a voluntary approach, and there are some good examples of that. The latest tranche of the BIS announcement yesterday included the commitment that the Government were working with the providers of store cards to make a number of adjustments. For instance, a number of colleagues in the room have been concerned about the practice whereby, when you buy something—it might be a Christmas present—you are offered the chance to take a store card. They will say, "You can have a discount on that if you take the store card today." We all know that store cards have relatively high levels of interest; you can probably borrow the money more cheaply elsewhere, and that might not be the best route. Therefore, people are being tempted down a route they really should not follow. So the Government have a voluntary agreement with the sector not to continue with that practice. Therefore, there are some things in there that I think are absolutely the right thing, and the voluntary approach is right.

There are areas, though, where there is such consumer detriment and such an imbalance, an asymmetry as it were, between the provider and the person in debt that the Government need to be willing to step in if those things do not work. For instance, in the announcements yesterday there was something about codes of practice for payday lending, suggesting that you could not have one code of practice but would need several because there are various different trade associations. It did not fill me with confidence that we would get on top of this fast. While I absolutely support the Government in trying the voluntary approach first, they need to be ready to step in if things do not work.

Dr Gathergood: More generally, private markets have two excellent instruments to improve the outcome for consumers, which are competition and reputation. Government activity should seek neither to restrict competition nor to reduce the opportunities for consumers to identify individual lenders and their activities. In general, I think some of the voluntary codes of practice are very generous. For example, bank undertakings with regard to unauthorised or unwanted overdraft use seem to have come a long way. Although there are some objections to the charges for these unapproved overdrafts, the fact that banks are willing even to clear balances for individuals who have not requested an overdraft yet have spent over their accounts, is in itself something of a generosity. There are areas in the market where it is not obvious that there is much in the way of competition or reputational functioning. For example, in the area of personal insolvency and management of debt through debt management plans, it is very difficult for consumers to understand which debt management companies are cheapest, or to get any kind of data on the outcomes for individuals who participated in these plans. These companies are many and various, so building a reputation is more difficult. The OFT has revoked consumer credit licences on the basis that some debt management companies were mis-advertising. When it comes to issues of reputation, one wonders how widespread those practices might be across the sector. I think it is difficult for the consumer to choose because they do not have enough information about which companies will give them the right product at the right price.

Q26 Rebecca Harris: So you are implying there is a role for the Government to play there.

Dr Gathergood: There is certainly a role for the Government to play, not necessarily to regulate and place strictures on how debt management plans work, but to make more information available to consumers. In the lending market the APR has to be reported by every lender; it is an indication of cost over a period of time. In the debt management market there is no equivalent. What is the typical amount of debt being discharged for someone on a particular debt management product? If consumers could see some kind of statistic on that, they might have some idea as to whether it is worth paying for the product. All debt management providers come up with anecdotal stories of people whose debts they have managed to discharge—someone who came to them with £100,000 of debt and paid it off in five years and similar—but that information is not widely available. Every lender can come up, I'm sure, with at least one individual whom they might have helped to a good outcome, but more data need to be in the consumers' hands for that.

Professor Ramsay: It is rather difficult to say whether the Government have got it right because there is so much going on at the moment, and we do not know yet what the future architecture of regulation is going to be in terms of the replacement for the FSA and the role of the OFT. Clearly, one of the issues is this optimal balance of regulation of the demand side, through trying to empower consumers, and regulating the supply side. It is not clear in terms of regulating the supply side how, for example, the irresponsible lending norms will be used by the regulators. For example, the Financial Services Authority attempted to get companies to embed norms of fairness within their structure within the organisation, so that they did not mis-sell—so that problems were prevented from arising rather than being dealt with at the point of sale. There is a lot of scope for that. We have seen that very intense competition in credit markets does not always benefit consumers where it is taking advantage of behavioural biases—for example, the PPI mis-selling scandal. In terms of those types of general issue, it is probably better to try and regulate the supply side.

There is a lot of talk of proactive intervention in the documents that are circulating at the moment, but it is not clear exactly how this will work in the new architecture of regulation. What is going to be important is the sort of powers and the approach that will be taken by the new regulators of the consumer credit market. For example, firms might be required to notify the regulator if they identify problems with a product, as they are required to do under the consumer product safety regulations. Those types of powers might be conferred on the agency.

The balance of self-regulation versus regulation clearly depends a lot on the context; I am not so confident in an area like payday loans how exactly self-regulation would work. Who would enforce it? Would it apply only to companies that had signed up to the code of practice? Would it be enforceable by the Financial Ombudsman Service in terms of a norm of fairness? There is the danger that self-regulatory codes actually make the law more opaque because you have to look at the statute, look at the regulations then look at the code of practice, so it is not necessarily the case that it simplifies the regulatory landscape.

Q27 Chair: Can I intervene on that point? Earlier you mentioned the obligation to notify, if a company had a problem with a particular product. What sort of problem do you envisage, and how would the company necessarily identify it?

Professor Ramsay: If, for example, endowment mortgages were started, then a company realised that this was not working out terribly well, you could impose some type of obligation to notify the regulator, who would then be given early warning that this might be an industry-wide problem.

Chair: Right, I see; we all have our scars.

Q28 Margot James: Of all the various credit products, which areas concern you most?

Joanna Elson: I have talked quite a lot about payday loans, so I will not do that again. John has briefly touched on debt management companies. I think that is an area where there is significant consumer detriment and it is worth looking at. When the OFT looked at these companies last year, they found over 90% non-compliance with the OFT's own rules; they found misleading advertising; and they found that poor advice was being given. The reason it concerns us so much is that we—and, I am sure, the other advice providers here—have people coming to us who have tried to put things right, responded to one of these adverts and winded up in a worse situation than when they started. These companies are taking up-front fees. They are making monthly charges of an average of 17%. They are making something like £250 million a year from this market, usually from vulnerable people who are essentially making a distress purchase. People are not shopping around; the OFT report found that. They go to the one that they see first that will help them. I think there is real consumer detriment there. I was glad to see yesterday that the Government are looking at this area and intend to do more research. We think that some action needs to be taken here quite soon.

Professor Ramsay: I would agree with that. The whole treatment of over-indebtedness and personal insolvency is an integral part of the credit market architecture. This is now recognised by international institutions such as the World Bank. We do not have much systematic analysis of it. We now have in England a complex range of overlapping alternatives for an over-indebted debtor: bankruptcy, bankruptcy plus an income order, an IVA, a debt management possibility, an administration order in the county court. It is difficult for the individual to know what to choose, which means the intermediaries, such as the debt management companies, have a lot of power.

We have a very large over-indebtedness industry in the UK; it has grown in a piecemeal way, often being driven from below by entrepreneurs, which creates a lot of noise for an individual trying to navigate the system. The system could be much simplified; for example, we could expand the debt relief order to far more individuals. It is a very limited process at the moment. There are many debtors who owe over £15,000 and have relatively straightforward over-indebtedness problems who could be processed in a relatively quick way. We might ask why people are not using insolvency, for example, rather than a debt management programme. Just to give you a contrast—I am not suggesting that England adopt this—France, for example, prohibits private for-profit debt management companies. That is just to show you that other countries do not necessarily take the same approach. I really think that we do not know enough about this area, and unfortunately I do not think the Government have done enough to simplify and modernise the system.

Dr Gathergood: I will briefly add to that. Payday loans are commonly disliked. I do not think we like the idea of people borrowing at these enormous rates or the amount of money that can be made from customers, but you cannot criticise payday lenders for not being clear about the terms of the loan; they are overwhelmingly clear and such loans are very expensive. Indeed, the APR works against short-term lenders because by its construction it exaggerates the cost of the credit that they provide. If you look on various adverts and various websites, they are really clear how much they charge, and it is a lot. In the case of personal insolvency and debt management, things are not at all clear. Academics and industry analysts at large struggle to say much empirically about the personal insolvency regime in the UK and the experience of UK individuals in debt management because we have very little data available on which to base these conclusions. We simply do not know the outcomes for IVAs or for DMPs.

Q29 Chair: I believe it was Professor Ramsay who said earlier that the level of indebtedness in France is actually less than here.

Professor Ramsay: That is correct.

Q30 Chair: You also said that France effectively outlaws private debt management companies. Do you think there is any correlation between those two factors? Is there a connection at all?

Professor Ramsay: I do not think there is a connection between the prohibition of private debt management companies and the level of debt. The reasons why the level of household debt in France is lower are various; this may be partly cultural and partly the existence of interest rate controls.

Q31 Chair: It is a fairly complex reason. Is there any evidence that the absence of private debt management companies is causing problems?

Professor Ramsay: In France, they have a single state over-indebtedness commission run by Banque de France, which is free to individual debtors. This means that the state is subsidising both creditors and debtors. It is relatively accessible to individuals. It has quite a high caseload. So I do not know that there is necessarily an absence of alternatives for debtors. The state over-indebtedness commission is quite well known throughout France.

Q32 Chair: Is there a lesson for this country in that?

Professor Ramsay: In relation to managing over-indebtedness, the issue is partly the balance between the public and the private. France contrasts very strongly with the UK because it has a totally public insolvency and debt management system, effectively. We have a much larger role for the private sector, and I think we have suggested that there are problems with that. The French system has perhaps the disadvantage that it is relatively costly because the state is subsidising both the creditors, really, in terms of their collection, and the debtors. So I think there probably needs to be some balance between these two extremes—one with this very large private sector and one that is dominated by the public sector. We should have a situation where, for example, creditors contribute their fair share towards the management of over-indebtedness.

Chair: Thank you, that is very helpful.

Q33 Julie Elliott: What can the credit and debt management industry do to improve and regulate itself?

Dr Gathergood: At a basic level, vast improvements could be made if there were more readily available information on which consumers could base decisions about which personal insolvency option or debt management option to take. A private sector solution is not necessarily a bad solution, because a private sector solution has the virtue of competition to drive down prices and increase quality. However, competition will be effective only if consumers have some basis on which to choose between competing firms. The absence of that information makes it very difficult for consumers to make a choice. The single, simplest, lowest cost thing that the private sector debt management industry could do is publish more data on the quality of its products and the outcome for consumers who take up their schemes. That would be a leap forward in terms of improving the functioning of the industry.

Q34 Julie Elliott: Do you think they are likely to do that?

Dr Gathergood: Well, they do not, which suggests that they have a private incentive not to.

Joanna Elson: Can I just build on that? If you look at some of the advertising out there, you will see on these websites a 30-second debt test that will tell you whether you are eligible for a Government-backed IVA—surprise, surprise, you are, and then you are down this route. We take 15 minutes at National

Debtline to work through with people, and we do not believe you can do it in less than that. We are forever trying to keep the times down because we want to be efficient, but we do not believe you can in all conscience give people a proper solution and work through their problems in 30 seconds. I think that is indicative of the problems that we have.

Q35 Julie Elliott: You mentioned credit unions, Joanna. Do you think there is a greater role for credit unions to play in providing credit to consumers, as has been suggested in the consultation response?
Joanna Elson: Yes, I do. Credit unions clearly are a very useful source of both affordable credit and simple savings for something like 900,000 people. Clearly that is not nearly the scale that would be needed to cope with complete demand across the UK. We welcome the fact that the Department for Work and Pensions is working with the credit unions on modernising and growing. There is a £73 million project to do that. I think that is absolutely the right thing to do but, in the meantime, you cannot wait for that to happen before you sort out some of these other problems.

Q36 Julie Elliott: Does anybody else want to comment on that?
Professor Ramsay: Credit unions are a tiny part of the UK market at the moment. Ideally, we might encourage them to grow, so obviously that is a useful objective in terms of providing an alternative form of competition in the market as well. But I think they can only be one part of the solution to high-cost credit. There are credit unions in other countries, and as they become bigger they become a bit more like regular financial institutions. It may be that the ideal of the small-scale credit union in a community is a very good idea but is not necessarily going to be a major solution to providing an alternative to the mainstream. I am not opposed, but I think one has to realise that they are a very small, tiny part of the market.

Q37 Ann McKechin: I wondered if you could comment; some of the evidence produced for the Committee suggests that in other countries mainstream banks are actually providing more of this type of credit than we experience here in the UK in terms of covering the market for people on low incomes looking for credit. I agree with you that credit unions unfortunately only have a very small share, but is it a fact that we do not have enough mainstream market products of sufficient range to allow true competition to occur?
Professor Ramsay: It is possible that your evidence was in relation to something like the Community Reinvestment Act in the US where the mainstream banks have an obligation to serve, for example, lower-income communities. They do this in a variety of ways. They often partner with community institutions, which might be credit unions, or work with communities. The general assessment of the Community Reinvestment Act is that it has been relatively successful. The question is whether that could be imported into the UK, and how we would get the mainstream financial institutions to do this, particularly in a period when they are under a lot of pressure in terms of recapitalisation. I think your point does draw attention to the fact that perhaps we have to think about how we can get the mainstream financial institutions to contribute more to lower-income communities, using perhaps the Community Reinvestment Act as an idea but not necessarily trying to import it lock, stock and barrel.
Chair: Thank you. That really concludes our questions. We have another panel to interview in a moment. I will just reiterate what I normally say at the end of one of these sessions; if you feel in retrospect that you would like to add anything to any of the answers that you have given today, feel free to submit further written evidence to us. Equally, if you feel there is an answer to a question that the panel neglected to ask you, again feel free to give us the benefit of your expertise on that. Indeed, if we feel in retrospect that we have not asked a question that we should have, we will be writing to you for a response as well. Can I thank you. That was incredible helpful, and there is obviously a high degree of expertise in this particular area. Thank you very much.

Examination of Witnesses

Witnesses: **Sarah Brooks**, Director of Financial Services, Consumer Focus, **Teresa Perchard**, Director of Policy, Citizens Advice, **Delroy Corinaldi**, Director of External Affairs, Consumer Credit Counselling Service, and **Martin Lewis**, Money Saving Expert, gave evidence.

Q38 Chair: Good morning and thanks very much for agreeing to speak to us today. You may well have been in when I made my opening remarks to the previous panel, but if you were not I will just repeat them. Obviously some of the questions will be fairly general questions. I would be grateful if every member of the panel did not feel obliged to comment on every question unless of course they either wish to contradict what another panellist has said or feel that an area has not been sufficiently outlined to us. We do want to get away some time before lunch. Before I start, can I ask you to introduce yourselves for voice transcription purposes? If we start with you, Martin.
Martin Lewis: Martin Lewis from MoneySavingExpert.com.
Delroy Corinaldi: Delroy Corinaldi from Consumer Credit Counselling Service.
Teresa Perchard: Teresa Perchard, Citizens Advice.
Sarah Brooks: Sarah Brooks from Consumer Focus.

Q39 Chair: Thank you very much. Unfortunately the representative from Which? had to withdraw today, but their submission highlights that the value of payday loans taken out by borrowers has increased from £1.2 billion in 2009 to £1.9 billion in 2010. What do you think are the reasons for this? Are there more loans or are they higher value loans, and are you concerned by it? Who would like to lead?

Sarah Brooks: We did some research on this market last year and we estimated that it had grown fourfold in a year, so we are not surprised by the latest figures showing that this market has grown. There are several reasons for that, which you have heard before, around the sort of macro-economics that people are experiencing. All sorts of indebtedness are increasing across the piece.

The other thing is to do with the growth of the market entrants. There are very low barriers to entry to the high-cost credit market: £500 for a consumer credit licence and obviously some checks, and away you go. It is obviously a very profitable market as well. So some of the reasons are to do with demand and some are to do with supply. What we have seen is that, without some checks on the market, the problems associated with the payday loan market will also grow as well.

Teresa Perchard: Can I just add to that? It is quite interesting. We give advice to 2 million people a year, and many of them have debt problems. Among our clients, the number of people who have debts to payday lenders has gone up fourfold in the last couple of years, so that is perhaps mirroring the fact that this is a source of credit that is fairly new to our market. We would expect to see debt problems with repayment.

That slightly contradicts the purpose of the product. It is intended to be a short-term, small-value borrowing to get you to the end of the month, and that is it. What we are seeing is that providers are rolling over loans and people never get to pay them back. We are also seeing that people are taking them out to pay off other debts. It is consumers doing something they thought was useful to help them meet their other credit commitments. Instead of turning to the bank or some other credit provider or using their credit cards, they have turned to this new supplier, which we have heard earlier is very accessible and very quick, with very few questions asked, so perhaps they feel it is quite discreet as well and they will not be judged if they use it. Given that on some estimates we have 5,000,000 people in need of debt advice, it is not surprising to see the market grow if people are using it to get them through to the end of the month and meet their commitments, which includes paying off other credit.

Q40 Chair: Thank you. Martin?

Martin Lewis: Let us make no mistake about this: the United Kingdom is a crock of gold at the end of the rainbow for payday lenders who have been shut down all over the world and have been regulated. We are unregulated; they are taking over our high streets; there is a massive supply of advertising. They are using technological means to make it very easy, very quick and feel, initially, very painless. It is an attractive proposition. It is simple; they give you the money. It is their limited credit scoring that's appealing.

You understand why people do it. While I would not want to shut them down completely, because we do not want to push people into the hands of real loan sharks, who threaten to rape your children if you do not repay, what we do need to do is not be the only Wild West for payday lenders. We need to start regulating how they operate rather than letting them regulate themselves. This is a massive growing problem that is only going to get worse unless there is some form of radical and quick intervention.

As Teresa says, though, it is not the loans themselves and those astronomically high APRs, which mean nothing; it is the rollover. It is the continued borrowing, which is when an APR and compound interest kicks in. It is wonderful that you are addressing this, but this needs regulating quickly because it is growing so rapidly that we are losing control. That is what we must do and you must tell the legislators that.

Q41 Chair: This brings me on to a question that occurred to me. I believe it was Sarah who said you just need £500 to enter into the market. If I, heaven forbid, decided I wanted to set up a payday loans company, what sort of regulatory hurdles would I have to jump to establish myself as a bona fide business delivering this service?

Teresa Perchard: Basically, if you are an out and out criminal with a record of violence or discrimination, which is one of the other areas of the law, you will not get a licence, but beyond that you do not have to prove any technical competence to get into the market. You will not be tested on your knowledge and you will not be tested on your business capability, whether you know about the service, whether you know about the law or whether you have enough money to run a decent business. It is easy.

Sarah Brooks: I would agree with that. One of the other problems is that there is no differentiation in the fees that the Office of Fair Trading will charge you. If you are setting up a business that is going to be more risky and need more supervision because of compliance problems, such as some of the issues around not all but some operators in the payday loan market, you will pay the same fee as anybody else. It is a flat fee. You can imagine that £500 does not buy you an awful lot of supervision.

With the payday loan market there are two types of detriment that arise: one, where firms do not obey the rules such as they are. That is around advertising and credit checks; some of them advertise that you just will not have a credit check. I hope we will have a chance to talk about credit checking later on. There is also an issue about the way in which they try to recoup their loans if you have problems repaying—when you have continuous payment authorities they can keep dipping in to your bank account, etc., etc. Those are the compliance problems, and the OFT has about 100,000 credit licensees, not all in payday loans but it is a big share of the market now to supervise.

There are also issues around regulation, as Martin has said. We know that countries like the United States have limited the number of rollovers, so you cannot roll over more and more times. If you are rolling over or taking out a loan five times, you have a long-term credit facility, so this is not suitable for you. At the moment we know that 3.2 is the average number of loans that consumers have in the payday loan market.

If we act now, we can act before the market is dependent on consumers operating that way, so there is still a window of opportunity here to legislate. We would say that rollovers and credit checks are really crucial.

Delroy Corinaldi: For those who do not know the Consumer Credit Counselling Service, last year we advised 400,000 people with debt management problems. That is more than 1,000 people a day. We see people that have multiple debt problems. You will come on to debt management plans and various other things later, and we are in that space. Last year we did not collect data on payday lenders, but this year we are. In August—as I said, we help 400,000 people a year—one in eight of those people who came to us had a payday loan. So there is a transition in the numbers of people having payday loans as a product. That is not to say there is not necessarily a need for them—some people want them and some people can repay them. Certainly, when we look at the data that are coming through to our social policy team, there are questions about the level of credit checking that goes on, and there are questions about the fact that these individuals have debt that they are struggling to repay and yet they are able to get payday loans. The other thing to reiterate is not all of the payday loan companies are as bad as each other, but we are now in a situation where there are so many of them and they have many companies underneath them, it is very difficult to tell which are the best and which are the not so good ones. In addition, you have the OFT, which is quite under-resourced and yet trying to deal with a whole host of companies in this area and, as we will come on to later, the debt management companies. It is a very difficult area.

Q42 Chair: You talked about broader regulation. Is there anything that could meaningfully be done at the initiation stage to stop irresponsible payday lenders opening up and starting their activities?

Martin Lewis: The first problem is that we have this farce of financial regulation being split between the FSA and the OFT, where the FSA is a lot more stringent than the OFT. The regulation Teresa talked about is not regulation; that is, "You are a criminal, you can't do it." It is a farce. I have a member of my team looking to write a guide to payday loans. We are going to call it Best Buy Payday Loans, and what it is actually going to do is list the 20 things you should do before you get a payday loan, the alternatives and everything you can check, and then right at the end it will tell you how to do it safely.

While researching, the member of my team found in the space of 10 minutes a payday loan company that is not registered with the OFT. We reported it to the OFT. It is not regulated, and for the ones that are, if most of the rates they are quoting are representative rates, then my name is Anne Widdecombe. It is just not true. Those rates are not representative. What they do is they jemmy them so that they have the lowest possible rate, which is not what representative APR should be. It is a farce and it does not exist.

So yes, the barriers should be far more similar to what the FSA operates for people who have an FSA registration. Hopefully there is going to be some merger of the two, but it is for the on-going protection of the public. While the Wongas of this world get a lot of stick—I am not a fan—they are a lot cleaner than some of the smaller ones out there. You ask how we would start; we would start by regulating because we are not right now.

Teresa Perchard: You really need to speak to the OFT about this because what they would probably say is, "We do what we can." They do have powers. They have powers to determine how much they are going to charge for the licences in the first place, having regard to the costs of regulating. This could enable them, if they generated more fee income from licences, to have the resources there to take action when they found out that one of these companies was in breach of the OFT good policy guide on responsible lending.

They could, more quickly than they have in the past, say this practice of rolling over small loans is irresponsible lending because you are not making a new judgment about why that individual needs that line of credit. They could take more action than they do. It is all about resources and get up and go, and evidence about what is going on in a fast-moving market of lots of small businesses, in most cases. It is just not designed for the job.

The consumer credit framework that we have was built for old-style consumer credit products that were not sold on the web in the blink of an eye. Product regulation and control of the design of these products would prevent some of this harm building up. It would be cheaper than regulators chasing after businesses after the event. That is why the opportunity to move credit regulation to the new Financial Conduct Authority is appealing because the product intervention approach is mapped out as the approach that the regulator will take.

Sarah Brooks: I just wanted to say a bit about some of the options for regulation because there is always the possibility of self-regulation. After we did our research on the payday loan market, we convened a round table with industry regulators and some of my colleagues here to see what we could do by agreement. To give them credit, the Consumer Finance Association, which represents quite a number of the players came along, as did Wonga and a few others, and they took forward a plan to put into place a code of practice to address some of the concerns that we and other organisations had. Disappointingly, we could not sign up to the code that was produced because we did not feel it went far enough. Some of the things would be nice for some of the consumers, but they did not get to the heart of the difficult issues for vulnerable consumers.

The Government yesterday announced that they were going to work with industry to drive forward the self-regulatory approach here, but we think there does need to be the stick of regulation if that does not work.

Q43 Nadhim Zahawi: I wanted to pick up on the point that Martin made earlier about Britain being seen as the pot of gold at the end of the rainbow for many of these companies because they have been shut down internationally. Sarah, you mentioned a couple of areas where we could look at regulation: the rollover and the credit check area. What are you seeing, Martin, that is best of breed around the world in terms of regulation? Which countries have got it right?

Martin Lewis: I think it is very difficult to find a balance, because we are absolutely guaranteed to have loan sharks if we close payday loan companies down. This is the same issue as the drugs issue. Telling people not to use them won't stop everyone, you need to also educate people about how to use them as safely as possible if they will. People are always going to need low-cost credit, whether it is right or wrong for them. What we want to do is provide it. There are other ways to provide it. You discussed credit unions before, and the Social Fund is something I would love to come on to later. I will just put in a marker now for that, if that is all right.

I think first of all, to go back to basics, one of the great problems is the APR percentages that companies are asked to produce are a farcical nonsense when it comes to short-term borrowing. I always use this example, and we will have a smile since it is a Tuesday morning. If we were in a pub and you said, "Lend me £20," and I said, "I will give you £20 but buy me a pint next week," and the pint cost £3, that is—I will not test you—143,000% APR. That is the problem with APR regulation on short-term borrowing because £3 on £20, over a week, if you compound it over a year becomes 143,000%.

The first problem here is that these lenders are advertising 5,000%. It means nothing and it is not putting people off. There is no price competition in this market, because if there were then nobody would do it. The current idea of comparison sites, which is a plan, is relatively weak; it is not about price. What we first of all should do is incorporate total cost. This should all be about cost; get rid of rates—rates are nonsense. Companies should have to dictate the cost of the loan, and there should be a limit on the total cost of any individual transaction, which includes rollovers, which is how I have come up with the rollover issue. I have not studied the numbers. It is not what I do; we look at individual products and what the system is now. As a concept, if you borrow £100, you should never have to pay back more than £150. That is roughly how I would do it; I would base it on cost. Do not take the £50 as my limit—that is conceptual. That would incorporate any number of rollovers, which would be effectively a ban on the number of rollovers going on. What you have to do, though, is be very careful, because the problem with the marketplace, with the proliferation and lack of regulation, is I go to Delroy as one lender, and I borrow from him but I cannot pay it off, so I then go to Teresa and say, "Can you lend me £150?" So effectively you have a personal rollover going on. We have to be quite careful about that issue.

If I were doing this, I would put a total cost cap on. I would talk to the decent players out there about what the total cost cap should be. I would make them portray total cost, which includes all possible fees, which they do not do right now. The APR is a farce. I will get on my normal hobby horse, as I do every time I give one of these. I would put compulsory financial education in every single school so that there is no one in this country, unless they have mental capacity issues, who cannot understand what they are getting into. At the moment what we have is a financially illiterate nation being duped by companies who have very swift and clever marketing.

Q44 Nadhim Zahawi: Thank you. Sarah, in your recent research, *Affordable Credit—Lessons from overseas*, you found that mainstream financial institutions from other countries were more willing to provide lending to low-income consumers. Why do you think that is not happening here and what can we learn from that?

Sarah Brooks: The example you are thinking about is Australia, I think. We looked at France, Germany and Australia, and in Australia there was a role for the mainstream banks in working with almost the equivalent Citizens Advice and CCCS in providing low-cost loans. Why is that not working in the UK? We held an event last year where we got together low-income consumers and industry providers and we tried to tease out some of the reasons why this is not working. Some of the banks were talking about regulatory hurdles to doing that, which was not particularly clear. We do need to do some more work in exploring that, but there are issues around cost.

However, there are also, we discovered, reputational reasons. For example, the first thing that anybody who works in high-cost credit has to get over is that, say, 40% APR would be very reasonable. I remember a colleague saying, "This not-for-profit company wants to charge 40% on a loan; that is absolutely ridiculous." But for a small organisation you would need to charge that just to cover your costs. Now banks could potentially charge less because of their scale, but they obviously need to turn a profit. There has been a reason in that they do not want to have those high APRs. They are worried about reputation, they are worried about being seen to discriminate between other firms, but perhaps if they could partner with organisations, as they do in Australia, that would help with some of the brand issues because it would be a sort of badge, and I am not setting up Citizens Advice as a lender here.

Martin Lewis: Can I just add in to what you are saying? Let us remember that banks do exactly this and they charge way more than payday lenders. If you go beyond your overdraft limit at the Clydesdale bank, at £35 per unpaid transaction, and you are £1 over, that isn't 5,000% APR—that is billions. So they do it, but they do not dress it up as interest rates. I asked a credit union what they could do instead. They said, "Well, we would not get in because we would have to use the payday lending infrastructure. If you lend £100 it will cost you a fiver, and that will be a 600% interest rate, so we do not want to do it." The whole way it is communicated is a barrier to entry for legitimate lenders because of reputational damage.

Sarah Brooks: I would agree with that. Certainly when we have raised with banks why they might not be able to provide small value loans, small units, particularly to holders of basic bank accounts, there are several issues. There is a distribution issue around small units—how they get that into their product lines when they would rather lend in thousands rather than hundreds—and the brand reputation of charging what they thought they might need to charge for the small units for high-risk customers, but it should still be a better deal than consumers are getting elsewhere.

Q45 Nadhim Zahawi: How have they dealt with that in Australia? Or do the Aussies just not care about brand reputation?

Sarah Brooks: I think partly with these organisations they have been able to explain what they are doing and to reduce the costs, because if this is the sort of Citizens Advice product, they get the kudos for working with them.

Teresa Perchard: We are not doing payday lending yet.

Sarah Brooks: It is only £500 for a licence. The other issue is, of course, that there are some things that the banks do that drive people into the arms of the high-cost credit industry. Those are some of the things that Martin, Teresa and Delroy have brought up, but there are other issues around what they do not do. They do not provide short-term credit facilities for people—people who either use their overdraft or do not want one or do not want a credit card. So there are some people who use these products because they do not want the temptation of a long-term facility.

Not everybody who uses a payday loan is irresponsible. Things happen in life. People feel that this is a way of controlling their finances. So the banks could do more to have a buffer zone. We know that yesterday there was a voluntary agreement that the banks do that, but that is maybe £5 or £10, which is helpful. Perhaps a larger amount, more akin to some of these small payday loans of £100 or so, would be more helpful.

Delroy Corinaldi: It would be interesting if you spoke to the BBA, for example, the representative body for the banks, because we have mentioned the idea of their members being involved in this market, and they say it is not an area that they want to get involved in. I guess the profit is not there and the reputational risk is potentially there as well.

Just talking about payday lenders in particular, in the UK, what we discovered at CCCS, because we only deal with people who are in debt, is that when people fall into debt and we approach the payday lenders and say, “Look, we have one of your clients; will you accept a payment from us?” a number of them reject the payment. They do not want to deal with us. I am sure we will come on to this later when we talk about the fair share contribution. We then ask whether they are going to support a debt advice charity in helping these people through financial difficulty, and a number of them push back on that as well. It is moving them from seeing it as an innovative way of engaging with people and making money to actually being responsible as well, and not all of them are committed to being responsible. That is part of the difficulty.

Ann McKechin: I am tempted to say that perhaps our mainstream banks should be working with the Post Office. That seems to be the most obvious way to rebrand it in a way that would help the people on the lowest incomes by providing exactly the types of products you are mentioning. They already have a readymade network for it; we will perhaps touch on that later on.

Sarah, your evidence stated your concerns that payday loan providers are not complying with their obligations. You mentioned three things: advertising, credit checks and the way in which they are pursuing repayments. I wonder if you could just give a wee bit more information about those three things, and say whether there is a difference between the Wongas, the major payday providers, which Martin mentioned have a known structure and practice, and the very small providers that set up for £500?

Sarah Brooks: We should be careful not to give Wonga too much good advertising, I think. There are so many different lenders, some of whom are better than others, and they are the best known.

In terms of advertising, we monitor the press and we see all the different claims that come in. The latest one is, “If you borrow from us, there is no interest, provided you pay us back within eight days.” There are other ones saying, “We do not do credit checks,” which is illegal.[1] There are all sorts of different ways in which they try to get you in, and once you have that conversation they can bring you in. We look at the OFT’s website, which gives details of the enforcement actions they have taken as they work through some of the complaints. That is the issue in terms of advertising, and there are plenty more examples of that. I can write to the Committee if you want further details.

In terms of credit checks, there is a big problem and it spills over to other parts of the credit market. One of the things that we looked at is whether payday loan and indeed other providers are doing proper credit checks to make sure you are not borrowing from here, there and everywhere, and you have no chance of paying it back. If you are, you should be sent to get some debt advice rather than robbing Peter to pay Paul.

We looked at those issues and we found out that the problem is that, despite the rules under which payday loans companies should take steps to do credit checking,[2] they were using some of their own methods. They were not necessarily going in through the main framework as is done by the Experians and Equifaxes to check that there were not loans elsewhere, and that means they were borrowing wrongly. The system works by not only checking but also putting into it. If I borrow something from you, it is your job to make a note on the system that I have done so. So somebody else can come along and see that I have this debt. If the payday loan companies are not putting the information in, other companies cannot check. Even mainstream providers could then wrongly lend because of that.

1 Note by witness: Correction: “Illegal” is not the accurate terminology. Advertising a loan in this way is listed as an unsatisfactory business practice a in the OFT’s Irresponsible Lending Guidance unless free of any conditions regarding the financial circumstances of the borrower.

2 Note by witness: Clarification: The OFT’s Irresponsible Lending Guidance states lenders must carry out an affordability assessment, and encourages lenders to include a credit check but this is not mandatory. Consumer Focus believes it should be mandatory.

Q46 Ann McKechin: Is that going on at a wholesale level? Could you give any idea of rough percentages?
Sarah Brooks: As far as I am aware, this is fairly commonplace practice among the payday loan market.

Q47 Ann McKechin: We are talking about £1.5 billion of debt that has not been properly recorded.
Sarah Brooks: It is hard to say whether they all do not record the debts. I really do not know, but one of the things we found is that there is no commitment to do this. I do not want to exaggerate this because it is very difficult to tell. The reasons for that are also very difficult to ascertain. If you speak to the Equifaxes, they would tell you that they make these products available, they are affordable and they are there. If you speak to the payday loan companies, it does not seem to be so clear with their products. They might say it is impossible to do the real time checks because the system does not work like that and it is very expensive.
It is very difficult, and we have tried, to get to the bottom of what is happening. In other countries like Germany there is one system, the Schufa, which is their credit checking system and which seems to be more widely used and recognised. However, here we have got to a system where the main providers, the Equifaxes, Experians and Core Credits, have for some reason not been used by the payday loan companies, who have set up their own systems.
Delroy Corinaldi: I guess we are quite fortunate in that, as I said, people come to us because they have multiple debts or they are referred to us because they have multiple debts. As a result of that—I think it was mentioned in the previous session—every year we produce an annual stats yearbook, which points to individuals, the type of debt that they have, their gender, etc. As I said in August this year, one in eight people had payday loans and we are now collecting those data on a regular basis, so that we can have a better sense of the types of people who are accessing payday loans and perhaps get under the headlines a bit more and look at some of the behavioural issues behind payday loans as well.
Martin Lewis: Generally, they are not on your credit file. There are only three companies that operate credit checking; there are only Call Credit, Equifax and Experian. It is not very difficult to check. Generally, payday loans are not on there and that leads to many problems.
Let us remember that there is a big problem with credit scoring, because unfortunately any application, even with a rejection, tends to go on your credit file and counts as a search, which is a problem in all forms of lending. For example when you want a loan, only by applying do you know what rate of loan you are going to get. If you then do not want the loan, you reject the loan but it is still on your credit file as if you had borrowed. There is a big problem there. My slight worry is that people apply to find out how much they will be charged, and that goes on their file and will then disenfranchise them from borrowing. Certainly, if you have the debt, we would like to see that on the credit file, but I am not sure that every application should be on the credit file.
Teresa Perchard: Your question is really what areas are they not complying with?
Ann McKechin: Yes.
Teresa Perchard: We would say that the business practice of some of the providers of payday loans—the rollover facility particularly, but also the way in which initial checks are done—does not comply with the OFT's guidance on responsible lending. There is that, and also there are a wide variety of practices around handling of debt. Again, they are not all in full compliance with regulatory guidance on handling customers in financial difficulty. Those are the key areas.

Q48 Ann McKechin: You have all referred to the fact that you think the OFT is not the best regulator, but to what extent do you feel any confidence that the OFT is trying to enforce existing regulations or has tried to mount any prosecutions of these companies?
Sarah Brooks: I think it is a bit unfair to say they are not the best regulator. I think they have a very tough job to do. We wanted to have a competitive credit market; we thought that might bring down costs, etc., but it has not, actually—it has just made it more difficult to police. I think they are trying to do a very difficult job in difficult circumstances, and perhaps they are not always given the full tools they need to carry it out.
They do take action against firms, but of course they need to be alerted to that as well. It is triggered by a complaint, either by an individual or perhaps by an intermediary. It is not necessarily a proactive way of doing it. So there is an issue with that, and if we had stronger regulation and perhaps, as we said before, an appetite to increase the barriers to entry, that would make their jobs easier.
Teresa Perchard: It has never been in the right place, the OFT.
Chair: Could I just intervene? We have a lot more questions and we are going very slowly. I have to give evidence on behalf of the Select Committee at another meeting and I need to be away fairly promptly. Make your questions and answers short, and of course if there is anything you wish to add, please give it in written form afterwards.

Q49 Rebecca Harris: I want to go back to an area we were talking about, which is the APR rates for short-term credit and whether they are a good indicator for customers of whether this is a good product for them or not. Are there any ideas that you have for a better way for customers to know if they are getting a good deal or to shop around for a short-term loan, if APR is not working?
Martin Lewis: The only advantage of APR is that it scares off people who understand it, even though it is a farce. My only minor regret for getting rid of it would be that, but unfortunately it is not scaring off enough people. I think total cost, based on a number of examples, is a good idea. There are ways to formulate this within the industry. That is the way it has to go on short-term lending. It has to be: if you borrow £100 over two weeks, you will repay this amount. That is what we need to be telling people. How would you compare if you were doing it

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yourself? You would ask yourself that question. If I borrow £100, and I pay it back in two weeks, how much would it cost me? If I pay it back in another two weeks later, how much will it cost me? It is the simple and bleeding obvious answer, if I am honest.

Rebecca Harris: It sounds simple and bleeding obvious, doesn't it? Is that the view of the whole panel?

Sarah Brooks: I think if you have transparent charging, that would benefit across financial services.

Delroy Corinaldi: Certainly, when our helpline staff and counsellors talk to clients, particularly those who are struggling in financial difficulties, they like to know what they are going to be repaying. That is the key thing for them. It is not about the APR because they are not looking at the APR; it is all about, "If I borrow this amount, I know this is the amount I will be repaying". It is often very difficult for individuals who have perhaps never borrowed money from payday loans; I do not know how many members around the table have actually been to a high-cost credit lender previously, but we think in different ways. Those individuals who are getting that money today from Provident or Wonga or whoever it might be, are asking the question, "How much, and how much do I repay?" That is all they want to know.

Martin Lewis: It is important to remember that a 3,000% APR loan could be more expensive than a 5,000% APR loan because of the fees. That is what makes it all slightly ridiculous.

Q50 Rebecca Harris: You said that people who understood what a 5,000% APR was would be scared off and would not take the product, which takes us back to the issue of financial education and how we might want to improve financial knowledge. Are there any views you have on this?

Martin Lewis: I have been running a campaign for financial education for a very long time, and what's needed is to teach every single child from an early age. We have 104,000 people who have signed the petition; I hope all members here, if we finally get it through the Back Bench Business Committee, will support it in Parliament. What we need is for both youth and adults to be financially educated. The Money Advice Service has a remit towards it. I know there was a letter to them the other day saying, "Do not take the money away from financial education." Why has that money been put into web provision when—I am rent-seeking here slightly—web provision of money information is one of the things we do rather well, as well as debt crisis information. It is a very competitive market out there. I run one of the biggest websites, so I would know. Via the Money Advice Service we are spending a lot of money on 60,000 people doing a test, rather than face-to-face advice and financial education. Well, I have already had 60,000 people use my website this morning. It does not need three months to do that. Where the Money Advice Service is putting the money is a really interesting point.

Financial education in schools, including debt lessons both in maths and in PSHE, is where you start. It is a long-term investment, and not a very expensive one, for society. It will be the thing that will stop all of us having to be here and wringing our hands every time some new clever devil comes up with an idea like payday loans that we have not regulated yet, and pulls a fast one until a couple of years later when people start noticing that it is trading on our high streets.

Teresa Perchard: Can I just add that financial education for adults is just as important, particularly to address the issues that Margot highlighted earlier, which is how to help people get a better deal and reduce their costs, improve their earnings, reduce their cost of living, and perhaps reduce the need for them to borrow from any sources. To provide that support in communities is something that Citizens Advice is doing increasingly, because we want to reduce the number of people who come to us for debt problems by supporting people earlier. It is entirely complementary to the campaign around education in schools.

Sarah Brooks: I just want to sound a note of caution because we absolutely support financial education—we think it is a good thing—but in a market that is very complicated, which seems to be geared to trip you up, it will never be enough. We also need to have measures to ensure the products are understandable.

Delroy Corinaldi: Very quickly, when someone is in difficulty, and a trigger is to go to a free debt advice provider like us, that income expenditure piece—when you do the budgeting bit with people and take them through what is coming in and what is going out—is exceptionally good for them. They will tell you that, because they then start looking at breaking down their budget and understanding it in a more formalised way. I think if we can get that message through to some of the parents and they pass it down, we are then in a position to see some real value from it.

Martin Lewis: We have a quite deliberately dramatised tool on the site: our budget planner. At the end you press a plunger and it tells you if you spend more than you earn, and we try to make it exciting. It has been downloaded well over 1,000,000 times. Unfortunately most budgets are just terrible. They look at a snap shot of the month and they say motoring; they do not say MOT and tyres, and repairs and petrol and breakdown. There is a problem that a lot of the public budgets that are put out there are very poor. They miss out Christmas and buying a sofa every three years, which of course needs to be accounted for over three years in the cost.

Once you do it properly with people and they start to understand that you do your budget and then go on to think about how you are going to manage your money afterwards—a budget is just a start; it is not the end but the start—it does start to work. These are tools that most people simply do not have themselves and they are not being provided particularly well. People like me and other consumer websites have them, and we have 10,000,000 users a month. It is a large amount of people, but the problem is that we tend to reach the people who know they want the information, not the people who do not know that they want the information and do not know what questions to ask. In many ways, I suspect, the proportion of my users who take payday loans is smaller than the proportion

of the general society, which is the same for This is Money or Which? and all the other websites.
Chair: I think we have probably given this issue a fair airing. Can I come on now to Julie now? I think one of your questions is likely to have been answered.

Q51 Julie Elliott: My first question has been answered, which was about education for young people and adults. I think you have well and truly answered that question without me asking it. The second thing I want to ask, and I asked a similar question of the previous group, is what role do you think credit unions have in providing consumer credit?
Sarah Brooks: The Government at the moment are examining how they can expand the role of credit unions by the use of the Growth Fund, and I think the results are expected in January. Our organisation has done some research, particularly with the Post Office, on how that could work. Certainly in other countries, credit unions are very much part of the landscape. In the United States, 20% of the market is credit unions. In this country there are pockets in Glasgow and other areas, where they have been very successful, but as a whole it is hard.
What we see is that the barriers to entry that any bank experiences are there for credit unions. People like to have a high street presence, there is the advertising, and there is also inertia—switching rates are very low from mainstream providers. So, there are all sorts of barriers there, but we think we need much more diversity in the market both for credit and for current accounts. It is not just about competition being more of the same but about different providers coming in and challenging the current model. We would very much welcome credit unions taking a bigger role.
Martin Lewis: Whilst I am a fan of credit unions conceptually, the problem is that their rates are not that good for a rate tart like myself, and that is what I do. Where are the best rates? It is not with credit unions. What is happening with payday loans especially, which is about quick, easy convenience, is also not replicated by credit unions. That is not a slur on the credit unions; it is partly the regulations, which are changing next year. But they are not a particularly attractive and easy proposition for many people, though we should enable them to be so.
It always interests me when people see credit unions as the panacea. I always think of a building society as the big brother or sister of a credit union. The problem is that when building societies grow, especially the really big ones, they give you profit forecasts, charge bank charges and operate in a relatively similar way to banks. There is the balance: how do you keep them small, friendly and community-oriented, which is when they tend to do the really good and beneficial things, but then have the quick shimmying operation and convenience, which is what people are crying out for, especially in the payday loan-type market. It is a difficult circle to square.

Q52 Julie Elliott: If you do not think payday loans are the answer at that end of the market, what kind of product can come in there to fill the gap?
Martin Lewis: I would first of all educate people. We need to cut bank charges to start with, so that people are not using payday loans to avoid bank charges, which, if you ask me on a technical basis, is the right thing to do, because payday loans can be cheaper than bank charges. You are often right to take a payday loan to avoid bank charges. That makes it very difficult. I am doing that purely on the basis of numbers, ignoring whether it is good or bad for you in the long run. On a piece of paper, certainly, a payday loan is usually cheaper than a bank charge. So, we need to improve that.
We need to improve education and budgeting so that people do not get there. What is happening to the social fund is just horrendous. You can get an emergency loan or a budgeting loan—a budgeting loan only if you are on benefits and an emergency loan for anyone with less than £6,000 of savings—which is at 0% up to £1,500. There are three big problems. One, it is very inflexible borrowing due to the repayment terms. People do not go to the social fund for payday loans because it is very difficult to repay them; it is rigid and strict, and the money is not out there. Two, it is a postcode lottery, depending on where you are. If you are in a poor area, they are all used up quickly; if you are in a rich area and you are one of the few poor people there, you're more likely to be able to get one. Finally, I believe it is going to become discretionary for local councils going forward, and I do not see, with the budget cuts at the moment, that they are going to be offering them. What we used to do is have a state-funded social fund that was there to supply short-term lending for people in emergencies, and in the midst of the payday loan boom, we are taking it away. I do not get that.

Q53 Margot James: Could you comment on the Government's response to the conclusions of the personal insolvency review, particularly with regard to debt management organisations?
Delroy Corinaldi: Most of you will know from our submission that CCCS brought debt management plans to the UK in 1993. We probably have the largest share of the market, even though we are a charity, which is about 30%. We look very closely at what the Government said with some concern regarding the role of fee chargers and whether or not more can be done to clamp down on them. Certainly, our clients are particularly concerned that more needs to be done. When you are in financial difficulty and you are looking to go on a debt management plan, it is a distress purchase; you are feeling very vulnerable. You are feeling quite embarrassed, and you will reach out to the first arm that reaches out to you, and that first arm tends to be the fee charger because they have the advertising budget. I heard Joanna from Money Advice Trust in the first session talk about this—the misleading advertising that goes on. If you go to Google, for example, and put in "National Debtline", you will be swamped by fee chargers who are trying to get in on that sector. I think more can be done in terms of the licensing conditions around debt management companies, around the regulation, and around the lack of transparency.
Martin Lewis: I do not do this—we tell people to go to them—but I think one of the problems is exactly as Delroy says. Within the financial advice market, we

have different tiers. There are tied agents, multi-tied, and independent financial advisers. Within the debt management market, Christians Against Poverty and the Consumer Credit Counselling Service are exactly the same as somebody out there who is trying to make a lot of money and is going to make your problems a lot worse. It seems to me you could have different categories and different stamps that you could call yourself. When some companies say they are free but then charge fortunes on the back end, they are free at the point of delivery only. A little bit of categorised regulation that says you have to use the right terminology would be very useful, and not particularly expensive to do.

Teresa Perchard: On the Government's response, as Joanna highlighted earlier, the regulator has reviewed the debt management market and found it wanting on a number of points about charges and quality, so there has been very clear evidence. That is backed up by advice agencies, who see poor and inconsistent service at a high price from that burgeoning market, but the solution proposed is to develop a self-regulatory protocol, just focusing on the debt management area. There are nearly 4,000 people with licences to undertake debt management at the moment, and only 17 are in the leading self-regulatory membership body, so it is hardly going to touch the sides in that market.

We think the response should have been stronger, and particularly to implement some legislation that is already on the statute books, the Tribunals, Courts and Enforcement Act 2007, which cost a lot to put through Parliament. It provides the means to bring into play a statutory debt management scheme, which would put all of the services that are being provided on the same basis.

Because it is a distress purchase, people do not go shopping for the best debt management provider; they are cold called. They are not comparing price or service, which in a way is the same as the payday lenders. There are real differences in what they are offering, and on debt management there is quite a significant consumer detriment there, and the regulator needs to define the product and the service to prevent that occurring, which is our view. "Disappointed" is the view.

Delroy Corinaldi: If I could come in quickly, all roads lead back to the OFT, of course, because the OFT has a role in regulating the sector, and one of the things we call for is an increase in the amount it costs to get a credit licence. There are many hundreds of these firms around, and the client does not know where to go. If the OFT could increase the size of the credit licence for these debt management companies, then you would at least start to drive out some of the bad players in the market. That would be helpful.

I think you have two voluntary codes for the fee chargers out there, DRF and DEMSA, and they are indicating that they are doing some good things. It was only last week or the week before that one of them identified a fee charger that is masquerading as a free-to-client debt adviser, and what they then did, which they saw as a success, was to make it public that they had actually put a fine against them and were trying to clean up their act. Well, who is the firm? They did not identify it. How much money did they make out of clients while they were masquerading as a free-to-client provider? They did not state that. I think there is a lot more that can be done.

Finally on the OFT side of things, we do not know who they are and we do not know how much money they made. It is quite likely that they are still walking around with an OFT logo on their website saying that they are OFT approved. A lot more needs to be done to clean up this sector, and it needs to be done pretty soon. As the previous session said, a lot more people are going to fall into debt.

Chair: I think we have the message. You have one more?

Q54 Paul Blomfield: On debt advice, do you think the Money Advice Service is best placed to co-ordinate provision?

Teresa Perchard: There is no reason why they cannot do that effectively. They have a statutory base for their existence. They also have a very good relationship with the Financial Services Authority to, for the first time, generate funding for money advice, debt advice, on a levy basis applied to financial firms—something that has been under debate for decades. They are undertaking a review at the moment, looking at what the services need to look like in the future. We are working very closely with them to make sure they understand what is currently available and what the needs are. There is no reason why they cannot be an effective co-ordinator. They have the resources and are being assisted by people like us to understand what the needs and requirements are in future.

Q55 Paul Blomfield: Specifically following on from that, Teresa, how is that going to affect you and the funding you receive to provide advice?

Teresa Perchard: It is difficult to be certain. Right now, the funding that the Government have been providing centrally for face-to-face debt advice in certain communities is protected for this financial year. Those services are still in place in many constituencies. The Money Advice Service has asked the Financial Services Authority to approve a budget for next year that will be sufficient to continue with those services for another year while decisions are made about what happens in 2013 and 2014.

If the service levels go down while demand levels go up in 2013 and 2014, there will be more limited capacity in CABs and other local advice agencies, and possibly also the National Debtline, which is funded out of some of that money. It could be open to competition, and that might result in a very different pattern of service delivery. At the moment it is difficult to say what capability the Citizens Advice Bureau service will have to deliver debt advice in two years' time.

Coupled with the reduction in legal aid funding for specialist debt advice, the funding cuts that are coming in under the Bill would mean that 100,000 people who currently get help under the legal aid scheme with debt problems would not in the future. We face rising demand and reduced resources, so you can draw your own conclusions from that.

Q56 Paul Blomfield: Martin looks like he is itching to comment as well.

Martin Lewis: The Money Advice Service is a good concept, but I think there needs to be some focus. It has unique properties to do things that nobody else can do, and I slightly worry that it is not focusing on what it can do uniquely; it is trying to brand build in areas where it is not necessary. I have spent two years keeping my mouth shut on this, and today is the first day I have said it, because I think we have got to that point. I have had e-mails from people who work in the organisation saying that it is trying to brand build and build a big website, if I am going to be absolutely frank and honest with you. Personally, I do not see the point.

I would love to have a stamp—someone to check that we are compliant and doing everything right, as I am sure many of the other big editorial money websites would love—that means we can say this is being done. We have 10 million users a month; I e-mail 6.7 million people per week. ThisIsMoney is big; LoveMoney is big; Which? is pretty big—all I believe very substantially bigger that the Money Advice Service. We all do our best. You might say that we do some things you do not like, in which case, come and tell us and we will try to improve it. But why are we spending public money competing with that?

I would love the Money Advice Service to be out there doing financial education, dealing with vulnerable people and giving face-to-face and telephone advice, which there is no provision to do on any other basis, and helping debt services. But at the moment it seems to be concentrating, to a certain extent, on brand building. They are going to hate me for saying that, but it is a very deep frustration of mine. Yes, it can do the job if it looks in the right place, is my answer.

Chair: Simon, did you wish to come in?

Simon Kirby: Only to say thank you very much, it has been a very interesting session. I represent some 30,000 people in the most deprived areas of the country in my constituency. The issues are very important ones. I thank you for your input and your frank and honest answers.

Chair: Yes, I think Simon has articulated that, as Members of Parliament dealing with these issues on a day-to-day basis in our constituency, we are appreciative of the work that is done in this area and ever-conscious of the need to improve it. Hopefully, this session will go some way towards doing that. I will repeat what I said to the previous panellists: if you feel there is anything that you have not covered that you would like to, feel free to give us some further written evidence, which will be incorporated into our final recommendation. That has been incredibly helpful. Thank you very much for your attendance and for being so disciplined towards the end.

Tuesday 29 November 2011

Members present:

Mr Adrian Bailey (Chair)

Mr Brian Binley
Paul Blomfield
Katy Clark
Rebecca Harris
Simon Kirby
Ann McKechin
Mr David Ward
Nadhim Zahawi

Examination of Witnesses

Witnesses: **Peter Crook**, Chief Executive, Provident Financial Plc, **John Lamidey MBE**, Chief Executive Officer, Consumer Finance Association, **Caroline Walton**, Corporate Affairs Director, Dollar Financial UK Ltd, **Mark Lyonette**, Chief Executive, Association of British Credit Unions Ltd, and **Des Milligan**, Chief Executive, National Pawnbrokers Association, gave evidence.

Q57 Chair: Good morning. Thanks very much for agreeing to come before the Committee. We are not actually scheduled to start until 10.45, but because the Government brought forward the timing of the autumn statement we are on a very constrained timetable this morning. So I am going to ask you to just go through the preliminaries before 10.45, and then we will start the questions at 10.45. Do not feel that you all have to comment on every question. If you wish to disagree on something, that is helpful and please do. If there is something you feel you need to add to any responses given earlier, again feel free to do so, but I do not need everybody repeating the same points. Could you introduce yourselves for voice transcription purposes? We will start with you, Des.
Des Milligan: I am Des Milligan, Chief Executive of the National Pawnbrokers Association.
Mark Lyonette: I am Mark Lyonette, Chief Executive of ABCUL, the Association of British Credit Unions.
Caroline Walton: I am Caroline Walton, Corporate Affairs Director for Dollar Financial UK Ltd.
John Lamidey: I am John Lamidey; I am the CEO of the Consumer Finance Association.
Peter Crook: I am Peter Crook, Chief Executive of Provident Financial Plc.

Q58 Chair: Thanks very much. We will not actually start the questions until the allotted time. If at the end of our session there are any questions we have not had time to ask, we will put them in written form to you and would welcome your written response. Similarly, if there are any answers that you would wish to give to questions that we have not asked, equally feel free to submit those in written form.
I shall start with a very general question. If one of you answers, others can comment if they wish to add to it, but do not feel obliged to. First of all, who are your customers? Why do people use your services as opposed to mainstream financial institutions such as banks? I will start with Des.
Des Milligan: Our customers come from all walks of life. Historically, pawnbroking customers were relatively poor, C2s and Ds, but more recently that is changing, probably because the banks are not lending as much. Now there are As, Bs and C1s, so all sectors of society are now going to pawnbrokers. The reason they tend to go to pawnbrokers rather than banks is that they tend to fear banks, and they do not trust them. What they like about the pawnbroker is that it is very transparent, clear, fast and friendly for them.

Q59 Chair: It is an interesting cultural change when pawnbrokers are considered far more respectable than banks.
Des Milligan: Absolutely.

Q60 Chair: Anybody wish to add to that? Peter Crook.
Peter Crook: Thanks, Chairman. Provident Financial is primarily a home credit lender. I think home credit is unique in how it works. Firstly, the loans are all underwritten face to face, and thereafter collections are made weekly at the customer's home. The price we charge is fixed, so the amount a home credit customer owes can never go up. It is quite different from many other lending products in that respect. When I look at why people use our services and which people use our services, they tend to be families on low incomes. Usually it is the female of the household, typically in a family of three or four, typically in work. If you look behind why they use us, there are three or four things that are really important to them.
Firstly, the application process is not too onerous, and it is face to face, so it is human; the customers can understand features of the product and they have the chance to talk somebody. Secondly, they appreciate the ongoing relationship that they have with the company; there is face-to-face contact every week, which makes them comfortable. Thirdly, and very importantly, they worry about what might happen when they miss a payment. With home-collected credit, there are no other penalties or charges, so if they do miss a payment they know we are forgiving and there is no extra burden. Primarily they like the transparency of the pricing. They understand where they are, what the weekly rate they have to pay is, and the fact that no other interest or fees are going to be added.

Q61 Chair: Just a quick supplementary. The fact that you are flexible and considerate in terms of non-payment, is that not abused?
Peter Crook: No, I do not believe it is. I think customers really value the fact that they can miss a payment, because from time to time they will have

bumps in the road; their income may be lower one week, their expenses may be higher one week. Ours is very much a weekly product because that is how these customers tend to manage their finances. They budget on a weekly basis, so if they can miss one week without being hit with a penalty charge or with extra interest, that is a feature that they tell us they really value.

Q62 Chair: What is your default rate?
Peter Crook: We lose between £25 and £30 of every £100 of borrowing, so clearly it is higher than a mainstream lender.

Q63 Chair: That is higher. And what sort of percentage of borrowers would that be?
Peter Crook: It is a fairly similar percentage, as the vast majority of loans we offer are in the £200 to £500 range, so we do not get a small number of borrowers creating a large debt charge.

Q64 Chair: I think you have covered some aspects of my next question, but what are the characteristics of the products you offer to consumers that differentiate you from others? John, can you start? I would be grateful if you could make your answers very pithy.
John Lamidey: Yes. CFA represents lenders who offer very small short-term loans, often called payday loans. Our customers come from across the age range, across the income range, but they are characterised by the fact that they have to have a bank account, they have to have a job—94% of our customers come from a household with at least one full-time worker—and they have to have disposable income. There is no significant crossover between our customers and the home credit customers, or indeed the customers of credit unions, which we will probably hear about in a minute.

Q65 Chair: Thank you. Caroline?
Caroline Walton: Just for the benefit of everyone, Dollar Financial is not a trading name. Dollar Financial UK has several trading names. We are also owned by Dollar Financial Corp, which is a Security and Exchange Commission publicly listed company in the US. Here in the UK we trade under the names of The Money Shop, Payday UK, Merchant Cash Express, and we also have high-end pawnbrokers—Suttons & Robertsons in London and Duncanson & Edwards in Scotland—so we have a range of different brands. In The Money Shop, which some may recognise from their constituencies, we have a range of products ranging from foreign currency, money transmission, pawnbroking, buying of gold, third-party cheque cashing and payday lending, which you have heard a little bit about from John.
The average customer who comes in for the payday loan is around 35; the average income is around £18,000, which is typical of the industry. All customers who come in for a payday loan have a bank account, so they are not financially excluded people, and they all have regular incomes in order to get the loan. The average loan will be less than £300.
I think the reason we differ from the mainstream is that the mainstream are not offering this kind of small value short-term loan. We hear quite a lot from our customers that they are struggling to get short-term small value loans from their banks. The other alternative for them is unauthorised overdraft, where fees are significantly higher than they are paying for the payday loan.

Q66 Chair: Mark, do you wish to chip in?
Mark Lyonette: Sure. I represent the credit union sector. There are something like 400 credit unions in Britain—England, Scotland and Wales—serving about 900,000 people now. Membership growth is reasonably healthy at 15% a year. Who are our customers? Well, it is quite a wide range, but the vast majority of our members are on low or indeed very low income through to about average income. We have what we used to call industrial credit unions, where people are on much higher incomes, above average incomes, but the sector predominantly serves low and very low income people.
Des Milligan: Can I just explain the characteristics of pawnbroking, because I think most people have heard of pawnbroking but might not actually know how it works? Customers go to the pawnbroker usually with jewellery; gold or diamonds are predominantly the things that are pawned. They get a cash loan after showing ID and various other issues, but very quickly—within normally 15 or 20 minutes. However, because they are borrowing money against assets that they already own, pawnbroking is really very different from other types of lending. If you think about it, you could just sell the items if you wanted to, because the pawnbroking loan is only a fraction, normally 10% or 15%, of the value of the jewellery that they have brought.
We never get people into debt, and because of that customers are incredibly satisfied. We commissioned some research from the Personal Finance Research Unit at the University of Bristol, which I saw the other day is the same research company that BIS are using now, so they are very good. They interviewed 500 pawnbroking customers, and 95% of them said they were either satisfied or very satisfied with the service.

Q67 Mr Binley: I come from a family who, a very long time ago, used the Provi regularly, normally to buy school uniforms and stuff like that, which was a sizeable expenditure for our household. I was concerned to hear you talk about a 30% default. Is that so, or did I misunderstand you?
Peter Crook: That is correct, Mr Binley. We write off probably 25% to 30% of the loans.

Q68 Mr Binley: Your write-up to cover that default must be 40% or 50% on your other loans.
Peter Crook: We price for the risk that we take.

Q69 Mr Binley: I understand that, but is that the case? Just so I understand, is your write-up 40% to 50%?
Peter Crook: Yes, we charge an all-in price that reflects the risks that we take and the costs—

Q70 Mr Binley: No, that is not the question I asked. Is your write-up 40% to 50% to cover that 30%?
Peter Crook: Yes, in effect it is.
Mr Binley: It is. Thank you.

Q71 Katy Clark: What does that mean as an interest rate? What would your interest rate be?
Peter Crook: If you borrow £100 from us you are going to repay £3.50 per week over 52 weeks, so that is a total of £182. The APR on that loan is 272%. From our perspective, and I think from most of our customers' perspective, and as you heard indeed last week from witnesses such as Martin Lewis, the APR is really not a very good measure for the costs of short-term credit. It is not something our customers particularly understand.
I think one of the biggest issues is that products like ours include all the charges; there are no extra fees, interest or add-ons, so everything is in the APR. Many other forms of borrowing do not include all charges in the APR, such as bank overdraft lending, for example. So I think it is quite difficult to compare APRs across different credit products because in many cases the APR does not include all the costs of borrowing. Our customers tend to look for the total cost of the credit and what the weekly repayments are.

Q72 Mr Binley: I am concerned about debt spirals, because at the rate we are talking about, that can add to it sizeably for a family. I am concerned about the checks and balances you might put in place, because it seems to me that you need to weed some of your customers out, quite frankly.
Peter Crook: Let me—
Mr Binley: Let me ask the question first. What measures do you take to ensure that people are not borrowing money who should not be and are in no position to pay it back? That seems particularly relevant following the question that I posed before.
Peter Crook: Yes, thank you. Firstly, to deal with the point on debt spirals, if a customer borrows on a home credit loan, the amount they owe cannot go up as we do not add extra fees or charges. So the amount they owe at the outset cannot change; it will not increase. If a customer misses a payment, in effect we will come back over a further week at the end of the loan. We do not roll over loans and add further charges, so I do not believe home credit contributes to so-called debt spiral.
In terms of your question on how we underwrite loans, we think about the three Cs. We look at character, capacity and condition, and our loans are underwritten face to face. Our agent will assess whether they believe the customer's intent to repay is good, and indeed whether there are any other issues—alcohol, drugs, mental capacity—that would preclude us from serving a customer. That assessment is carried out face to face in a customer's home, so as you can imagine, if you are in somebody's front room you will get a pretty good feel for whether they are of a character that is going to or will want to repay.
In terms of capacity, we are looking at the household budget, so we are looking at the money coming into the household, and how safe, secure and persistent the income streams are. We are usually lending to the lady of the house, but generally we are looking at multiple streams of income coming into the household, usually from the man in the house as well, in order to fund the repayments, and we are looking at the household bills. Our agents can take a forward-looking view, so they can factor in potential increases in fuel bills and so on.
Finally in terms of conditions, we are looking at what other obligations a customer has and how well they are looking after them. So to be honest, it is a pretty sharp assessment of the customer's circumstances, as it is done face to face and in a forward-looking way.

Q73 Mr Ward: You are obviously dealing with what could be deemed high-risk clients. In your case, Des, you just keep the gold or jewellery if there is a default. What procedures are used within the industry to deal with this 30%? Presumably you do not just announce that you are going to write it off. What is the practice in the industry in terms of trying to recoup? Do you pass the debts on?
Peter Crook: In Providence's case, David, obviously we are calling on the customer face to face, so we generally have the ability to diagnose what the problem is. If it is a temporary problem, we will not take a payment for a period of time or we will take part payment until the customer's circumstances improve. If there is no prospect within a reasonable time scale of that customer bringing their account up to date, it is written off.

Q74 Mr Ward: No court action?
Peter Crook: We go to court in very rare circumstances. It is not usually cost-effective to pursue very small debts through the courts. The only reason we go to court typically is because a customer has more than adequate income and assets to pay but has decided not to. If I looked at how many people have gone to court out of our 1.8 million customers this year, it is about 250 for the first nine months.
Mr Ward: 1.8 million. That is a lot.
Chair: Can I bring in Paul Blomfield? I shall come back to you, Brian.

Q75 Paul Blomfield: You say you do not roll over debt, but how many repeat loans do you have? What percentage of your customers take out a further loan?
Peter Crook: Quite a lot of our business is repeat business.

Q76 Paul Blomfield: How much? Could you quantify that?
Peter Crook: It is probably about 80%. I think that reflects the nature of why people use our credit. They tend to dip in and out of using credit from people like us when the household budget does not balance. That could be at particular points in time when white goods or brown goods need renewing or replacing, or at seasonal times of the year when customers need a bit of extra cash.

Q77 Paul Blomfield: So although you are not rolling over debt, you have customers who are carrying large levels of credit year on year on year.

Peter Crook: We have very few customers who are always on the books. It is around 10%.

Q78 Paul Blomfield: I thought you said 80% repeat.
Peter Crook: A lot of people come back to us, but that is usually when they have finished a loan or are about to finish a loan.

Q79 Chair: Going back to Brian's first question about debt spirals and preventive measures, would other witnesses quickly summarise what they do in those areas?
Caroline Walton: When customers are coming into the Money Shop store, for example, to take out a payday loan, they have to go through an assessment. They have to bring in a bank statement and a payslip, and they fill out a questionnaire. We also do an Experian check on all new payday customers. We go through a detailed explanation with the customer about their ability to repay that loan. Right at the outset there is quite a lot of face-to-face assessment that goes with the customer's new transaction, as well as the credit scoring that happens, to try to avoid those situations of people taking on loans that they cannot afford.
Mark Lyonette: It may be worth adding that as credit unions we try very hard to be responsible lenders; obviously we do not want people not to be able to repay, both from their perspective and from the credit union's perspective. I think it is worth pointing out to the Committee a couple of things we have been lobbying for and raising for some time in terms, for example, of the paucity of information in credit reference agencies, particularly the further down the income scale you go. Government itself needs to consider whether it contributes more data on debt to those agencies. Things like that are very helpful for people, such as showing a good credit record in terms of continuing to pay the rent to the housing association. All those things would be really quite helpful to make sure that we are not indebting people who cannot afford to repay. So there is another part of this around helping the industry to make better decisions, which certainly the credit unions would be very keen on.
Des Milligan: If I can make a small addition to Mr Ward's point; at the end of an unredeemed pawnbroking loan the gold is sold. That is true. Happily most people in fact redeem—between 80% and 90% redeem. If it has to be sold at the end any surplus goes back to the customer; the pawnbroker does not keep it. Incidentally, by law he has to get what is called true market value for the item, so he is charged with getting a very good price for the customer.
Chair: That is interesting. Can I come back to you, Brian?

Q80 Mr Binley: I spoke to your conference about three years ago, so I declare that interest, and I am really quite supportive of the Provi, quite frankly.
Peter Crook: Thank you.

Q81 Mr Binley: But we needed to get those facts out; I think they are important, and they make the point that you are actually responsible actually. I want to put this to Mr Lamidey particularly, because I think it hits as much with him as anybody: how do you make sure your customer understands what they are signing for when they take out a loan or when they take out credit?
John Lamidey: Payday lending is regulated in exactly the same way as all other consumer credit lending. There is no difference. We are required to provide the pre-contract information, the right of withdrawal and all the things that everybody else has to do. We have the huge advantage, of course, that our product is probably one of the simplest you could ever find. You borrow a sum of money, a couple of hundred pounds, and you contract to pay that money back with the charges on a particular day. There is very little to misunderstand. There are no hidden charges. Any extra charges that could occur have to be made clear up front, because that is what the regulations require. So we do not think there is any danger at all of our customers not understanding the product, unlike for example a credit card. On my credit card four different rates could be applied, depending where I got the money from. With our loans, it is very, very simple.

Q82 Mr Binley: But many of the customers who get into serious debt have, as a part of their debt loading, relationships of the kind that you have just mentioned.
John Lamidey: They may well have, yes.

Q83 Mr Binley: Let me finish my question. I am simply explaining the situation before I get there. I repeat: what steps above and beyond regulatory requirements do your members take to ensure that people are not overloaded? It is all very well to say that they know exactly what they are doing. We know that many people at all levels of society, in an acquisitive society, in fact think they will get by without really deeply considering the concerns, and that is why they get into trouble, so I wonder how you go the extra mile.
John Lamidey: Firstly, there are two different delivery methods. You have heard from Caroline the delivery method from high street stores. We also have a delivery method online, so people can apply for a loan and contract for it online.
There are four specialist businesses operating in the UK that provide data and indeed identification verification to payday lenders. One of the difficulties we have had with the mainstream credit reference agencies is that they were built up on mainstream lending and their data is normally only refreshed once a month. That is not good enough for us, because the whole length of the loan may only be a month. We have specific businesses that are offering close to real-time data on people's other commitments, so we are able to check with them.
I have to say that with online applications we turn down about nine in 10 applicants. We have a very high turndown rate because of the checks we undertake to make sure that people are creditworthy and the loans are affordable for them.

Q84 Mr Binley: Good God, you are worse than banks at the moment.

John Lamidey: In what sense are we worse than banks?

Q85 Mr Binley: If you are turning down like that. Could I go on to my next question, Mr Chairman? Thank you. I want to talk particularly about payday loans, which is a growing business. I think the number has gone up from 1.2 billion in 2009 to 1.9 billion in 2010. That is a massive sector increase. We have heard that the number of people with unmanageable debt has increased. My guess is—you might correct me—that payday loans are related to the rather more desperate end of the borrowing sector. Can I ask if you think there is a correlation between those figures, and am I right in thinking that more and more people are turning to payday loans because the world is becoming a more difficult place for them?
Caroline Walton: There is quite a bit of evidence to suggest that those on the lowest incomes are not actually using payday but are using revolving credit, in terms of credit cards and overdraft facilities, and they are increasing, obviously, as times are becoming difficult. What we find is the payday loan being used as an alternative to going into unauthorised overdraft, and I believe that what we have seen is an increase in payday lending because there is more awareness of this alternative form of lending. For many years people have been subjected either to borrowing long-term higher values or to borrowing in the unauthorised overdraft arena.
It does not really matter whether you get bad publicity about payday lending because awareness of it has increased. People are seeing a real, viable choice between the alternatives that they have had and what they could get today from a payday lender, so I would not suggest that desperate times have driven people to a payday lender. Incomes that are being constrained, people on pay freezes, overtime being cut and fluctuating pay packets mean that people have made an alternative choice.

Q86 Mr Ward: The Government has responded to a number of consultations, and features of that are protections for the consumer but also improved debt advice. I just want reflections on the Government's response to the reviews that have been carried out.
Peter Crook: In overall terms, Mr Ward, we welcome the approach the Government is taking. I do not think it is the Government's role to say whether products are good or bad; I was pleased to see that in the Minister's statement. I think it is the Government's role to make sure that consumers are protected, which means that they can make informed choices, the products they use are simple and transparent, and when things go wrong they are treated appropriately and fairly.

Q87 Mr Ward: On debt advice, obviously there is a need to provide protection for people and transparency and information. But how far should it just be left to the market, in your view?
Caroline Walton: For debt advice?
Mr Ward: The whole issue of consumer credit.
Caroline Walton: I think certainly we should be, and we are, engaged in directing people to free debt advice if they find themselves in any financial difficulty. Certainly Dollar Financial trading organisations refer people to free debt advice, such as the CCCS, Citizens Advice, etc. We should continue to play a key part in doing that.

Q88 Mr Ward: So if someone approached you for a loan, and the purpose of the loan was really the fact that they were in debt, what would your reaction be?
Caroline Walton: We would refer them to debt management or for debt advice. For example, Dollar Financial have a relationship with Credit Action. We have leaflets in store that can direct people to Credit Action or the CCCS if they are in financial difficulty.

Q89 Mr Ward: So it would be part of your diagnosis of the situation to advise them to seek debt management advice?
Caroline Walton: Yes.

Q90 Chair: Do you have any arrangements with debt management companies?
Caroline Walton: We work with debt management companies offering free debt management, or indeed the payday loan debt management companies. We work with them on an electronic basis, which speeds the whole process up. So, yes, we do.

Q91 Chair: Do you receive any commission?
Caroline Walton: No, we do not.

Q92 Rebecca Harris: This is another question to Dollar Financial. We were told last week that the United Kingdom is a "crock of gold at the end of the rainbow for payday lenders who have been shut down all over the world and have been regulated". Would you like to comment on the veracity or otherwise of that?
Caroline Walton: From Martin Lewis, I understand.
Rebecca Harris: Yes.
Caroline Walton: If we go back a little and look at the alternatives for the consumer, this was and is still a market that is relatively immature. There was nowhere for the consumer to go for that short-term loan, or for the small value loan, so it was a market that was not being serviced. What has happened is that others from other countries have seen an opportunity, and indeed it was not just American firms that came in; UK businesses were also developing payday lending here in the UK. But there was a market opportunity.
It is a bit unfair to assume that it is as easy as finding a crock of gold, because a lot of work goes into the customer service that we offer. Customers come to the Money Shop store, for example, through recommendation, and if you do not provide a good service, you will go out of business. There is also a lot of regulation that has to be followed, which is why we are working with the CFA with Government on a code of practice because we take it very seriously, being responsible lenders. It is not the easy pickings of "it's a crock of gold". A lot of effort goes into it.

Q93 Rebecca Harris: What about the accusation that payday lenders have been shut down all over the world?

Caroline Walton: Certainly in the US there have been rate caps, which have meant that payday lending has been closed down in certain states. That is not to think that there is an opportunity to do it here when there was not an opportunity in the States, because there are other states in the US where, talking with the businesses, rate caps have been introduced, and the rate caps have been able to sustain some payday lending. Businesses from the States may have arrived here thinking that there is no regulation, but what we are looking at is regulation within the payday industry and an enhanced code of practice, which will drive out anybody who sees it as an opportunity to carry out unregulated payday lending.

Chair: Can I bring in Paul Blomfield before I come back to you?

Q94 Paul Blomfield: In what I am sure you would describe as a more mature market in the US, why do you think so many states have chosen to regulate where they have that experience of the sector?

Caroline Walton: I think it has been a bit of a misunderstanding of the consumer, and a rather rash and prompt response to the view that a rate cap would solve the issue and what would happen, bringing down the cost of a payday loan, when in actual fact the rate cap drove out the payday and in some cases made it far less competitive. Because unless you were mature and you had a good book and all the infrastructure in place it would be very difficult.

Q95 Rebecca Harris: This is both to you and the CFA. How do you respond to accusations that you have not been complying with your obligations on responsible lending? We heard some of that last week.

John Lamidey: I have to say as a trade association that I have never had a case referred to me that demonstrates that. I find there are a lot of assertions about the industry and about what we do. When I try and get hold of a tiny piece of evidence it is elusive. We have, for example, the normal consumer credit complaint system, which takes consumers through eventually to the Financial Ombudsman Service. We have so few complaints going through to the Financial Ombudsman that we have not actually got enough to have our own category in the Ombudsman's report. When you see the Ombudsman Service report coming out every three months with thousands of complaints about various parts of financial services, you will not even find a category for payday because we have fewer than 60 in a three-to-six-month period. So I am at a loss to understand where the evidence is. We run a payday loan forum where I have Government Departments, consumer groups and other trade associations, where these sorts of things could be brought up. They have not been, so I have very little evidence to go on.

Q96 Rebecca Harris: Do you want to add to that?

Caroline Walton: Certainly this lack of responsible lending is not something that I am familiar with. We take it incredibly seriously. We have 2,500 people employed here in the UK, and we go through extensive training with all the frontline staff to make sure that everything that we have put into place is followed. We go through the responsible lending guidelines to make sure that we are fully compliant. We follow the Consumer Credit Act and the directive that came in this year in February. A lot of time and effort is placed into making sure that we are responsible lenders. In addition, as a trade association who were founder members of the Consumer Finance Association, we are working very hard on enhancing that with the code of practice.

Q97 Ann McKechin: We heard in the evidence that there are many hundreds of organisations and companies now working in the high-cost credit market. The Government has stated that it would prefer to remedy problems by self-regulation. Could I ask the panel what the consumer credit industry can do to improve and regulate itself, and what would your response be to a code of practice? How would that actually work when we have a large number of players in the market?

John Lamidey: Can I try to address that? These ideas have been floating around for a while; the idea of a universal code of practice that covers all consumer credit, or certainly unsecured consumer credit with different strands for the different general product types, has been floated. There has not been a lot of support for it, I have to say. To have a code of practice just for those in what is termed the high-cost credit industry would be quite difficult, because, as I hope we have shown you today, we are very different sectors of the market. We do not have any crossover with home credit; we are completely different types of lending. We do not have any crossover with credit unions, and I do not know whether we do with pawnbroking. But to have a code or practice that tries to have universal standards above the level of legislation would be quite difficult. The Consumer Credit Act has been revised three times in the last decade and I was involved with all of it. I do not think there is a lack of regulation. We do have interesting practices in some areas.

Q98 Ann McKechin: With great respect, the Consumer Credit Act came about before the payday loan market in our high streets actually ever arose. So would you not agree it is outdated?

John Lamidey: I totally accept that but no, I do not think it is outdated, because what we have done with consumer credit is to regulate the lending process rather than trying to regulate products. As soon as you try to regulate an individual product you have to define it, and when you define it somebody produces a product just outside your definition.

Consumer credit regulation regulates how you do your lending, whatever sort of product you are giving. A lot of the reviews have been quite recent. The Consumer Credit Directive was passed in 2008 and came into UK law in 2010 or the beginning of 2011. So these things have been taken into account. I sat on working groups with BIS on those regulations, so I do not think anything has been overlooked in terms of the regulation. But your question was about codes of practice. We have a code of practice, which we launched this summer. We are working on that with BIS right now to enhance it.

Q99 Ann McKechin: This is for your association members.
John Lamidey: Correct.

Q100 Ann McKechin: The fact is that there are different sorts of trade associations running around in the high-cost credit market. You have stated, John, that you think it would be very difficult to have a common code, so how is that market going to be monitored, and how are people going to understand when sanctions are applied? What level of transparency can people then expect?
John Lamidey: What the Department for Business is trying to achieve at the moment is that those trade associations that have payday lenders as members all incorporate in our codes of practice the same standards that will apply to payday; and you are entirely right, there are actually four trade associations that have payday companies as members. That is the Department's attempt, and we are co-operating entirely with that.
We are very keen on regulation, but you must not discount market forces. A lot of these businesses are quite new and a lot of them are quite small, and with the Government's overall regulatory reform agenda and the potential for new regulation in the fairly new future, you may well find that the market does contract or coalesce, and you will have fewer businesses because the standards that are required will remove anybody on the fringes.

Q101 Ann McKechin: Does the panel think it is sufficient that if you have £500 in your hand you can apply for a licence from the OFT to set up as a payday loan company and—bar basic checks on your criminal record—that is it? Does anyone actually think that is really an adequate standard for entry?
John Lamidey: That was the standard that was reached when they reviewed the Consumer Credit Act and came up with the Consumer Credit Act 2006. The allegation before that was that it was too easy to get a licence. The other point of view on that is if everybody has a licence you can take action against them. If they do not have a licence you cannot. So the licensing regime was entirely reviewed. It was changed and the OFT were given more powers. You can still get a licence, of course you can, but then you are subject to regulatory control. I personally think that is a really good idea.

Q102 Ann McKechin: Does anybody on the panel have a view about £500 being an adequate sum for inspection and regime?
Des Milligan: I have a view. John is absolutely right. It is not just a question of the OFT checking whether you are honest or not. These days you have to prove that you actually understand the lending business that you are in. There are CRP1 forms to complete and various other things. They quite often do spot-checks and interview people who are applying, and we work closely with the OFT, and obviously our members, to ensure that they actually do know what they are doing and are going to be compliant.
Mark Lyonette: One of our problems with the OFT, and this is not necessarily a comment on any individual at all, is that new bad practices spring up all the time and whether they have the resource and ability to always spot them is questionable. For example, one of the things our members have been saying for a while is that there was a big growth in credit brokers promising credit and referring people to credit unions when they had no prospect of getting a loan at all, but charging people for that privilege. We are pleased that in the Government announcement that is now going to be changed; once a lender says, "We have no relationship with you as a credit broker", the credit broker is no longer, in the guidance, going to be allowed to refer people to credit. But it is very frustrating because these little things keep appearing. New things appear and I am not always sure there is enough resource and perhaps enthusiasm to deal with some of them quickly enough.

Q103 Ann McKechin: Okay. John, can I ask you, with your own practices and within your own trading association, why do you think that Wonga, which is one of the larger payday lenders, is not a member but many others are? And how do you advertise when you have actually imposed sanctions against any of your members who have failed to comply with your own standards?
John Lamidey: I will deal with Wonga first. I am not totally sure about this, but I have a suspicion that Wonga joined a trade association before we even existed. We were only formed in October 2008. They have chosen to join the Finance & Leasing Association, a large, prestigious trade association. I know of no reason why they would not choose to join us, but they already belong to a trade association.
In terms of sanctions, our code of practice was only launched this summer. In the current version we do not have compliance monitoring or a method of dealing with members who do not comply, because I have only a very small number of members and they were the ones who wrote the code of practice, which reflects their practices. I have not got too much of a problem with that. But in the revision that we are doing now we intend to have annual compliance monitoring and a complaints handling system enshrined in that, so we are working towards that. But I have to emphasise that we are not a trade association that has been around for ever; we have only been around for three years, and we are working on this because, as you have deduced, it is an industry that is developing.

Q104 Katy Clark: Peter Crook has already said that he does not think APR is necessarily the best indicator when looking at these kinds of issues. Could the panel say what they think the best way of having price comparators for short-term credit would be in this sector so that the consumer is able to understand the deals before them, and compare them and shop for the best deals?
Mark Lyonette: I think from our point of view we have long advocated some sort of total cost of credit where it is pounds per 100 borrowed—something quite tangible. I think we would agree with many of the criticisms of APR for anything under an annual loan, so I think something needs to be done there. I

understand the Government committed to doing some further research on that, and we would certainly welcome it.

Des Milligan: We would just like clarity. We argued for years, I have to say, with both BIS and the OFT because we wanted to add to the agreements that customers were getting into with pawnbroking, how much it would cost them per month to borrow some money. So if I borrow £100 today, how much is it going to cost me each month that the loan will be standing? And believe it or not, it was illegal for us to include that information in the agreement until February of this year. Luckily, common sense prevailed and we can do it now, so we do. So we would strongly advocate a very simple, "How much is it going to cost me, either per month or possibly per day, to have this debt?" People understand that. They are very good money managers actually, customers who go to pawnbrokers. They are quite savvy, believe it or not, because they have to be. But they do want to know how much the loan is going to cost them.

They are not interested in APRs, and as we just heard, irrelevant for loans that on average are three and a half months. The maximum a loan could ever be is seven months. In fact the median value is only £90, so we are talking about pretty small amounts of money for pretty short amounts of time. People just want to know how much it is that they owe; that is it.

Caroline Walton: I have to agree with both Des and Mark here. The customer actually sees it in terms of pounds and pence, and they make that comparison with others in the same sector in terms of pounds and pence. Also, when they talk in terms of the difference between a payday and an unauthorised overdraft, they have no APR to compare with, so again, they see it in terms of how much they have had to pay at the bank as opposed to paying for a payday loan. I think measuring it in terms of the cost in pounds as opposed to a percentage APR would be very beneficial.

Peter Crook: It is perhaps worth mentioning in respect of home-collected credit that there is a price comparison website, lenderscompared.org.uk. The way those price comparisons are presented to the consumer is very much through the total charge for credit and the weekly repayments as well as the APR.

Q105 Katy Clark: Have you got suggestions about how the costs of high-cost consumer credit could be reduced for customers? If you are against the capping of interest rates, how else could you cap the total cost of credit? Is that something that could be looked at?

John Lamidey: Could I have a go at that one? I think the absolute key here is competition, because, as has been discovered, capping a charge does not make the loan cheaper; it simply makes it unavailable. All you are doing is reducing choice for consumers, and you are reducing competition because another product has gone from the market. It does seem to me that competition is the driver for this, and one of the things we find with payday lending is that there are, at the moment, quite a large number of businesses, both big and small, in the market. There are people starting to offer some quite interesting deals. One that was severely castigated—not one of my members—in the press recently was offering a 0% payday loan for eight days, and the media said this was terrible. But nevertheless, competition is there and that will—back to my previous comment about market forces—drive this probably much quicker than regulation ever will.

Q106 Katy Clark: If there was going to be a cap, do you think an actual cash cap, rather than a percentage cap, would work better?

John Lamidey: You cannot separate the two. The interesting thing is that our detractors have certainly always talked about a cap on the annual percentage rate. That has now changed to a cap on the total charge for credit. The irony is that in the way the regulations are written, that total charge for credit is what you use to calculate the APR, so a cap on total charge for credit is no different from a cap on the APR. This has been demonstrated in a lot of research, some in the United States where there have been interest rate caps for a while, and I have to repeat it: you do not make the loans cheaper. Only competition will do that, not just simply saying, "You cannot charge more than a certain amount", because that will drive people out of business.

Q107 Mr Ward: The Government sees credit unions playing an increasing role in providing consumer credit, which presumably you approve of. But is there a possibility that it will lose some of its uniqueness. In my experience that is very much a local form of finance, often locally controlled. As it grows bigger and bigger, is there any danger that it will lose that unique characteristic?

Mark Lyonette: I do not think so, David. We are very supportive of the work the Government has done. For Members who are perhaps not aware, the sector has made something over half a million loans in the last four or five years, all in the £200 to £400 area. At the time I think people were very sceptical about whether the sector would be able to do that so effectively. I think it is that good experience that has minded the Government to pursue whether there could be an expansion and a modernisation of the sector.

We absolutely recognise that we need better channels, for want of a technical term, to be more accessible and available, and hence why we are so interested in the potential partnership with the Post Office as well. We also recognise that in those half million loans we have probably had an impact on the home credit market in areas where the credit unions have been most successful. We are probably a lot less able to compete with the high-tech, payday-lending Wonga model because even at the prices it charges, it is only that price because of quite sophisticated automation and credit scoring behind the scenes. That is not something, of course, that our sector has been able to invest in or been able to deliver. So we recognise the role of innovation and development otherwise we will not get that way.

It was interesting listening to Caroline. I should say that about 90 million people use credit unions in the States. They angsted for a long time over whether they should offer an alternative to the payday lending product. In the end, a number of them did at a much lower cost with the same features—for example, eight days, ten days or the end of the month. But actually they made themselves a requirement, because it is not the first loan that is ever the problem. As Caroline said, from an economic point of view, that could be rationally the best way to get £100 or £200 for that period of time compared to banking overdrafts. However, whether you can afford that is quite different from whether it is the cheapest way of doing it. If people are still in it two or three months later it is really a budgeting question, if people are spending more than they are earning, so the real solution is around addressing the budgeting side. The credit unions have linked in that process, so if they have somebody who has rolled over a payday loan, albeit a much cheaper loan, they absolutely do some work with them to say, "Look, you have to balance this out. This is not good for you."

Q108 Mr Ward: Do you restrict loans to your own savers?
Mark Lyonette: Credit unions historically would have tended to lend as a multiple of how much you had saved over 13 weeks, six months or whatever. That is a lot less common now. It is still there, and sometimes credit unions will use it to manage risk. Much more commonly, unions feel able to work out whether somebody can repay a loan and the chances of that on day one, so many credit unions do not make that plan.

Q109 Mr Ward: It used to be a requirement, did it not?
Mark Lyonette: Not a legal requirement, no. It was more of a policy than a regulatory or legal requirement. In the days when credit unions did not have access to credit data it was felt to be a way you could manage the risk. In effect you were limiting your liability, weren't you? If somebody had £100 and you lent them £300, then at least some of the money is offset.

Q110 Mr Ward: Do you and the others feel that when people approach you for loans they should be made aware of credit unions? Do you see that as part of your responsibility at all, or is that Mark's job?
Mark Lyonette: We have suggested, and I believe one of your witnesses last week was talking about this, that in the same way that there is an obligation in the debt management industry to make people aware that there might be cheaper or free alternatives available, it might be something that is worth thinking of in this area. You would not be able to recommend any particular institution; it would be more like a wealth warning where you actually suggest that there might be cheaper ways to do this.
Peter Crook: It is perhaps worth mentioning that on the lenderscompared.org price comparison website that I mentioned earlier, credit unions are listed. Anybody looking for a home credit loan will see relevant credit union offers from unions that have chosen to use the site, alongside what the home credit providers offer.

Q111 Mr Ward: This question is to all of you. Going back to something I was trying to get at earlier on, you no doubt see yourselves as, and no doubt you are, standing between what can be the quite desperate needs of some desperate people in desperate circumstances and the loan sharks of this world. So you are the acceptable face of high-risk, short-term loans. These are risky clients who have a very high default rate. The difference between yourselves and the loan sharks is possibly extortionate rates, but also the methods of collection. How do you go about that? You obviously cannot be seen as a soft touch otherwise you would have an even higher level of defaults. How do you manage that balance?
Caroline Walton: Certainly with the payday customer you have to have some regular contact during the loan period. The face to face certainly helps with the store—to be able to talk through the repayment methods etc.—but we will also make contact with the customer before the loan is due to be paid to remind them of the repayment process. That helps the particular customer in their budgeting and planning. If the customer has not paid their loan then obviously there is a process of trying to encourage them to start making some form of repayment, whatever it might be, just to keep them in the cycle of paying against their outstanding loan.
Mark Lyonette: Compared to our colleagues here, we are the only people who are deposit takers, so from our point of view we are also interested in the saving side of the balance sheet. I have always been astonished, since I first got involved in credit unions, that when you talk to people who have had their lives changed by joining the credit union, they tell you that it is often not the credit that is so important. If we lend somebody £300 compared to a higher-cost lender we are probably saving them £150 in credit costs on that one loan, so it is quite a significant saving if you do it several times a year. But it is what they do with the £150 they save, which is what the credit unions will often tell you is important. Yes, people have lots of other things they need to spend money on to survive each week, but if you can encourage them to put even just a little bit aside, even if we are talking £1 or £2 a week on the low level, it is that kind of small scale savings habit that often redresses the balance of credit and debt and saving.
There are two ways of paying for things, aren't there? It gives people a confidence; it is a bit of an emergency buffer, but it is also importantly that people feel more in control. Credit never makes anybody any richer, does it? Accumulating assets, even at a small scale, is what makes us wealthy and gives us more confidence. So there is a part about savings.
Another thing features in all of this. Caroline has talked about the link between banks and overdrafts, which are certainly not regulated in the same way as these other products. You have to think about transactional products as well. If one of the reasons people dip into using a loan at the end of the month is because they have actually just found they need to, then in some cases—I am taking my colleague's point that generally at the low end people are good money managers—it might be around their use of transactional products as well. It is notable in the UK that because of our free in-credit banking model we do

not have banks that offer budgeting and bill payment accounts because it would actually destroy the model. I am trying to link that there are some other things to think about apart from credit regulation when you look at people's use of credit. Savings are one thing, and the use of transactional products and the availability of different kinds of transactional products are also part of the picture.

Des Milligan: Just so that the record is clear, with the pawnbroking agreement, obviously the pawnbroker does not have to pursue the customer for any outstanding debt, so that is very easy. I would add one final thing, which is if you needed to borrow £100 and went to a friend to borrow £100 for a month, and you said, "Right, I tell you what, at the end of the month I will buy you a couple of pints to pay for it," that is probably going to cost you more than going to a pawnbroker.

Mr Ward: It will in London.

Q112 Katy Clark: Credit unions set up in parts of my constituency following the collapse of Farepak five years ago. And as you will know, those people still have not got any money back because they are considered unsecured creditors. The kinds of mechanism that a lot of people use—paying up for something, paying so much per week or per month—do not seem to be regulated. Is that something that you have experience of?

Mark Lyonette: Yes, we gave evidence to the Farepak investigation. That was an absolute tragedy. They were people who were generally not widely known to exist really in Whitehall, but were people who were doing the right thing, saving for Christmas rather than getting themselves into a right state by January. In their mind they had every reason to think that what they were doing was protected. It is quite a theoretical distinction, isn't it? What is a deposit and what is actually a payment in advance? I think the Government has done what it has done so far around that. It certainly spurred a trend in new kinds of Christmas savings products. Both credit unions and other providers started to introduce products and encourage people to save for Christmas. But that would be a good example, Katy, of exactly the sort of thing I am saying. You cannot think about credit in isolation of what else we do with our money: whether we save instead of credit and whether we use transactional products are all part of that mix. While they come from different parts of Government, which is often one of the challenges—it is different Departments and different civil servants—you have to think of some of these things in the round.

Q113 Chair: Thank you. That concludes our questions. As I said earlier, if you feel there is anything further that you would like say, please submit it in writing. Thank you very much for your contribution; we will obviously be analysing it and making recommendations in due course.

Examination of Witnesses

Witnesses: **John Fairhurst**, Managing Director, Payplan, **Richard Wharton**, Director, General Secretary and co-founder, Debt Managers Standards Association, **Melanie Taylor**, Head of Corporate Relations, Gregory Pennington, **Chris Davis**, Chief Executive Officer, MoneyPlus Group, and **Andrew Smith**, Debt Resolution Forum, gave evidence.

Q114 Chair: You heard my opening comments. We are very much time-constrained by virtue of the fact that the Chancellor has brought forward the timing of the autumn statement, and I intend to finish by 12.20. Any questions that we would like to ask but have not been able to in that time we will put to you in writing, and we would be grateful for a response. Can you just introduce yourselves for voice transcription purposes, starting with Andrew Smith on the left?

Andrew Smith: I am Andrew Smith, I am from the Debt Resolution Forum. We are a trade association for fee-charging debt resolution companies.

Chris Davis: My name is Chris Davies, I am the CEO of MoneyPlus Group.

Melanie Taylor: My name is Melanie Taylor, I am Head of Corporate Relations for Gregory Pennington Ltd.

Richard Wharton: I am Richard Wharton, Director and General Secretary of Debt Managers Standards Association, or DEMSA.

John Fairhurst: I am John Fairhurst, Managing Director of Payplan, who are one of the free-to-consumer debt advice providers.

Chair: I will repeat my strictures to the previous panel. You will be asked some general questions. There is no need for everybody to comment unless you either wish to contradict or add significantly to what the previous speaker has said.

Q115 Paul Blomfield: Thank you, Chair. I wonder if you could briefly scope out the marketplace for us in terms of how demand for your services has increased in the last few years. And could you quantify the rise, if that is the case? Who are your main customers in terms of the demographic, and how has that changed in the current economic climate?

Andrew Smith: I would say that the market in general for debt resolution services at the moment is declining, not increasing, but not by much. If you look at personal insolvency statistics you will see that if you add bankruptcies and debt relief orders together they have pretty much plateaued over the last couple of years. It looks as if individual voluntary arrangements—IVAs—have reached a plateau of about 40,000 cases per year. I understand from market intelligence that it looks as if that will reduce by about 8% to 12% in the last quarter of this year.

A very, very significant factor is that large numbers of IVAs are now being done at very low levels of disposable income and debt, something that was not true a few years ago. It appears to us from the figures we get from members that IVAs at that level are cannibalising informal debt management plans, but they are still probably running at several hundred thousand a year. But as previous witnesses have told you, it is very difficult to get hold of that information. What is clear is that there appears to be an inverse relationship between jobseekers and joblessness and personal insolvency. As the number of jobseekers in the economy goes up, so personal insolvency goes down. At the same time you can see, from the amount of credit that people are taking, that a significant number of people are actually succeeding in paying down debt. They are not necessarily the group that have debt issues, but there is less debt in the economy. We have an economy where a large vector in growth is consumer spending. What we now know is that the economy for personal debt has changed very, very significantly. Four and a half times as many people a year choose personal insolvency, use personal insolvency, than was the case in 2000. That is not going to go away. The insolvency figures are going to start to rise again, and the informal debt resolution figures I would reckon, about 18 months to two years after the banks start to lend. This is the bottom of the curve, not the top.

Q116 Paul Blomfield: Is Andrew's assessment shared by everybody else? If anybody has a different view perhaps you could focus on that.
Richard Wharton: As far as the intelligence we get from our members is concerned, the market has certainly not increased, it is virtually static. It is not decreasing by much; I would agree with those comments on that basis.
Melanie Taylor: I think the only area where we are perhaps seeing a change is in the type of individual that is coming to us. We are actually seeing more professional working people seeking our services than there perhaps were 12 or 18 months ago.
Andrew Smith: I will add to that. My company clears debts. Demographic information over the last five years has not really changed much. We simply say there is one debt demographic; if you are a person who is in debt, the more you earn the more you owe. Other than that, it is what you would expect in terms of the proportion in each social grouping, gender and age. But as Melanie says, if anything it has shifted slightly towards the better off, people on average wages or above, but only slightly.
John Fairhurst: Just a brief point about the demographics. Our clients are typically homeowners in work, and that has been an increasing trend in recent years. That demographic is atypical of the one traditionally accessing face-to-face services, so the consumers we are talking about here tend to be people who would not traditionally use face-to-face advice services. They would use organisations like those represented here today.

Q117 Paul Blomfield: In terms of the marketplace, do you see any changes in the people presenting themselves, seeking support, as a result of high-cost loans?
Chris Davis: Can I come in? I would agree with all the comments made by the other members of the panel. Our figures are pretty static, but we are now seeing a greater proportion of consumers coming to us who have gone to a payday lender and perhaps rolled over and then gone to another payday lender, whereas if we look back at our figures a couple of years ago we would never have seen that mix. We are seeing a greater increase in people who have borrowed money from those sources.
Melanie Taylor: I think that is perhaps also causing people to delay the time that they take to seek advice, because it is almost like a bridge to an income shock or an income deficit. So although they are already heavily indebted, it is actually at that stage that they are going to get help; it is perhaps one, two or three months on from when you would expect.

Q118 Paul Blomfield: Do you think the delay means that during that process they are getting even more indebted, and the problems they present with are greater?
Melanie Taylor: We are seeing increasing charging for people who come to us at that point. But that said, we are finding that relationships have strengthened over recent times with those lenders and actually they are working very hard to recognise people in difficultly and to refund those charges.
John Fairhurst: And I think that is a very real concern. Our average client has a household deficit of around £800 a month at the time they call us for help. If they are bridging that gap using payday loans then it does significantly extend not just the time it takes to seek advice, but the time to repay debt. Although quite rare, we have had clients with an excess of 20 payday loans, people who have habitually used these loans as a way of managing that deficit budget. I welcome the comments made in the first session today about the steps being taken to address those issues, but it is the repeat users that cause the problems. It is access to credit for people who really should not be given credit.
Melanie Taylor: Yes, there is definitely a budgeting issue where you have somebody who is perhaps having difficulty managing their finances, but they are taking further borrowing almost to delay addressing that.

Q119 Paul Blomfield: Could I move to a different area? I am conscious of the time and the Chair is pressing us. Can I ask you how you build your business? How do you acquire new clients? Do you sit back and wait for people to approach you, or do you actively seek them out through cold calling or referrals?
Melanie Taylor: Around 15% of people would be referred to us by existing customers. We advertise on the internet, so we receive a large proportion through online advertising and promotion. From a Gregory Pennington point of view, we have actually been offering debt management services for almost 20 years so it is not something that is new to us or something that we are inexperienced in; comments have been made about new entrants to the market

because of the financial difficulties people are experiencing.
Andrew Smith: Citizens Advice were under the impression that we cold-called as an industry, and we were included in a super-complaint earlier in the year. The OFT concluded, when they reported, that the industry does not cold-call for clients.
Richard Wharton: I was going to make the same point exactly with regard to the CAB super-complaint.
Melanie Taylor: Certainly for the reputable part of the industry I think it is fair to say that.
John Fairhurst: It is worth noting that we operate a different business model. Our funding is via fair share contributions rather than fees, therefore we do not have the advertising budgets. Almost all our business arrives as a result of a referral from a third party, the biggest single referral being the free-to-consumer advice sector, the face-to-face sector. Creditors are one of the major referrers of cases, as are trade unions, large employers and people like that. So there are two different models of client acquisition and two different models of funding our operation.

Q120 Chair: To all of you, what is the typical fee for a customer on a commercial debt management plan?
Richard Wharton: The typical fee would be an initial fee, which would usually be between one to two months' cost of the initial disposable income, and then an ongoing management fee, usually of around 15% to 17.5% per month.
Melanie Taylor: In the case of Gregory Pennington, it would be an initial fee to establish the client and to negotiate with the creditors and work with the client on their budgeting. Then it would be an ongoing 15% monthly management fee for as long as the client chose to continue using those services.

Q121 Chair: Does anybody have a significant variation?
Andrew Smith: No, our numbers would be similar to those described by Richard.

Q122 Chair: I was going to come to Payplan next. How does the fair share model compare to that?
John Fairhurst: With the fair share model, 100% of the consumer's repayments are passed on to creditors, and then those creditors who choose to support our work, which thankfully is most, will separately pay us an amount in support of that, a sort of fair share. That fair share is linked to the amount overall that we pay to that creditor, a sort of polluter pays principle.
In our written submission we estimate that this is a substantially cheaper way of providing debt advice. We estimate that overall consumers pay in the region of £250 million a year in fees, and that reduces repayments to creditors by £150 million when compared to a universal application of our fair share model, so it is a very different model.

Q123 Chair: You have touched on my next question. How much longer does it take to pay off debt for a person on a commercial debt management plan with fees as opposed to a free debt advice plan?
John Fairhurst: It is determined to an extent by the level of surplus income a person has, but a couple of years would be a common extension.
Melanie Taylor: I think it is also dependent upon how well the debt management provider actually works to negotiate refunds of interest and charges and how successful they are in being able to negotiate concessions and to stop future interest and charges being applied. Then I think how good the service is to actually work with that customer to help them with budgeting and hand-holding to get them through the financial position that they are in.
Andrew Smith: Also I think the total length of time that a debt management plan takes is less relevant than it might seem at first. I imagine that later somebody might ask us about the length of debt management plans and the reasons for failure. But the fact is that a significant number of debt management plans do not go to term, and a very significant proportion of those that go beyond the first couple of years do not go to term because the person actually gets into better circumstances and feels able to repay their loans properly. So it is not quite as simple as it might first seem.

Q124 Chair: I am not sure if that actually rebuts the point that was made by John Fairhurst. Would the figures that you gave us incorporate what has just been said?
John Fairhurst: This is the typically one or two years' extension to the—
Chair: Yes, the length of time.
John Fairhurst: Yes, it depends. For people on very low surpluses it can be longer; for people on very high surpluses it can be shorter.
Melanie Taylor: I think it is also very much about the service that you offer to the customer and your ability to work with the lenders to make sure you get good concessions for them. Obviously if you are not providing a good service it does not really matter whether or not you are using a provider who does not charge you a fee, or charges it as a fair share to the creditor, or charges it to that individual customer. The customer is not going to continue to work on that debt management plan and continue to reduce the debts if the service is not providing for them.

Q125 Nadhim Zahawi: Mr Davis, you have been very silent. Can you tell us what your organisation charges, and answer some of the questions that your fellow panellists have answered?
Chris Davis: Yes. Again, we will charge a consumer the equivalent of two months of their disposable income.

Q126 Nadhim Zahawi: That is the up-front fee?
Chris Davis: It is the fee that we charge for all the work to put the plan in place. So we perhaps will speak to a consumer today. We will go through a very detailed income expenditure breakdown with the consumer. We will then correspond with the consumer. We will wait to get information back from them, we will process that, and it is only then that a contract will be entered into between ourselves and the consumer.

Q127 Nadhim Zahawi: What is that contract? What is the monthly charge beyond the two months of disposable income?
Chris Davis: We charge a very transparent monthly management fee.
Nadhim Zahawi: Of what?
Chris Davis: If a consumer pays up to £200, we will charge them £35. We are seeing on average at the moment that our consumers are paying about £165 per month. So in those circumstances we will charge a consumer £330 for all the work that we put into actually putting the plan into place. Going forward we will charge a monthly management fee in those circumstances of £35.
For that we will receive the payment from the consumer. We will distribute the payment to his or her creditors. We will negotiate with all the creditors to try and freeze interest and stop the late payment charges. So I think you see that there is a charge for the actual work that we do, but also what sits behind this is the added stress and pressure that the consumer is facing when they first contact us. We are seeing that our average consumer has seven debts. They may well be in arrears and in default with every single one of those creditors, so they will be getting letters, telephone calls, text messages and potentially visits. Our aim is to try and take the stress and pressure off the consumer's shoulders, and I think it is very difficult to actually put a value on that.
When I have the time to listen to some of the calls, and we tape-record every single call to our building, I can hear the distress and the pressure that the consumers are facing. When they immediately find out that actually there is a solution to their problems if they choose to take our advice, you can feel and hear the stress lifted off their shoulders almost immediately.

Q128 Chair: Do any of you sell any other financial services to customers who come for debt advice?
Richard Wharton: As far as DEMSA members are concerned, some of them will provide some other services, some insurance-linked products or maybe some income protection policy. They will not provide loan products. DEMSA members do not offer loans or lending products to consumers, but they may provide some other service in the form of some insurance products.

Q129 Chair: Would they recommend a type of insurance product to somebody?
Richard Wharton: No, it would be on a non-recommended basis.
Andrew Smith: DRF members offer debt resolution products excluding loans. Some members help people to reduce household spending by looking at other areas of their spending, such as utilities etc, but that is all.
Chris Davis: We offer something called bill shrinker to the consumer. It is provided by a third party, and allows that company to look at what the consumer is spending on utilities. Again, we do not offer loans to any consumers.

Q130 Chair: Do you receive any commission on the bill shrinker?
Chris Davis: A very, very small amount from a third party.

Q131 Chair: How much would that be?
Chris Davis: It might be £1 or £2 per consumer.

Q132 Rebecca Harris: We have the Government's response to the personal insolvency review. What are your views on that response in regard to the debt management advice?
Andrew Smith: There is potential for a huge opportunity to be missed, rather than looking at things such as people's ability to understand debt; I think the excitement around financial education is really misplaced. Firstly, as I think you have already been told, most people who get into debt do so because something changes in their life. It can be good or bad. It can be redundancy or illness. It can be good: it can be having a child, which is something that often precipitates debt. But often it happens as a result of personal change and sometimes it happens because of economic change.
A lot of people can do something about their debt, and they are very well aware of what they have taken on. They took everything on knowing they could afford to repay. There is a group, however, that is amongst the poorest, the least well educated, the least likely to be employed, who have difficulty with this. But the financial education that you are currently thinking about will not help them at all. We are sending one in five of our school leavers out into the world functionally illiterate and functionally innumerate, and in that sense financial education would do nothing to improve their chances. They are a very big part. That one in five is a very big part of the people at the bottom of the debt heap, the most excluded about whom you cannot do much.
So put financial education to one side and look instead at the other opportunity you have, which is to create a debt resolution culture in this country that rewards people who actually do something about their debt. You have to look at what happens at the moment. You have bankruptcy and debt resolution orders. Debt resolution orders are "bankruptcy lite" for people who cannot afford anything else. Bankruptcy could become the procedure for people who are not prepared to do anything about their debt. You then have individual voluntary arrangements and debt management plans. One of the characteristics of the people who come to all of us for IVAs and debt management plans is they want to do the best they can to repay. They are going to spend a significant number of years working hard, putting all their disposable income into repaying what they owe. And at the end of that the banks treat them like funts—financial untouchables—and they should not. At that point what should happen is you acknowledge that somebody has spent a long period going without, repaying all they can afford, and you should put them back in a position to be part of the financial community. They do not need financial education because they have spent five years, 10 years, learning how to budget and repay their debt.

I think in England and Wales we should look at the Scottish Debt Arrangement Scheme, which is pretty close to being the finest informal scheme for dealing with debt. We should look at the thing that we nearly got a few years ago, the simple IVA, which would have been a lower-cost version. Within hours of the Insolvency Service announcing something that was going to be put through on a legislative reform order, somebody—we do not know who—raised an objection and it was decided that the simple IVA would not go ahead. If you create a see-saw and the man stays on one side of the see-saw whilst he is solvent and able to repay most of his debt, then he is in something that looks like a debt arrangement scheme or the protocol compliant debt management scheme that the Insolvency Service are currently investigating. If he pivots over to the point where he cannot pay his debts when he falls due, then he could rocket straight into a simple IVA, and you could bring debt forgiveness into the equation and understand that the guy would still be doing the best he could to repay his debt over five years.

If in that time the person became unemployed or ill, you could take the enforcement restriction order. I am dumbfounded that with the rise in unemployment at the moment, that piece of legislation, which is in the Tribunals, Courts and Enforcement Act has not been used; the opportunity to have a six-month stay on everything that you pay, principal and interest, whilst you suffer unemployment—I gather that the average period of unemployment in this country at the moment is about 90 days. So for over half the people that became unemployed, what they owed would not rise in that period and the creditors would only suffer a gap in their payments, not a gap in their balance sheets.

Q133 Chair: Could I ask for a point of clarification? You talked about a simple IVA. Could you explain how that is distinct from the IVAs we have?

Andrew Smith: Certainly. IVAs at the moment have to be voted in favour of by 75% of the creditors by value. The difference with the simple IVA is that was to be reduced to 50% by value, and a creditor not voting would have been deemed to be voting for the arrangement, so small creditors who currently tend not to vote would be included in that quarter. The simple IVA would probably have cannibalised around a third of the invisible non-regulated debt management plans that currently exist, and bring them into a visible regulated environment.

Chris Davis: Rebecca, one of the things that disappointed me about the Government’s response was perhaps enforcement. There are two trade bodies represented here today, which has to be a good thing for the consumer. We are a member of DEMSA. I am very proud of that as a company. The OFT logo appears on all our correspondence, our website and my business cards. When I go to meetings I bang the desk about being a member of a trade organisation. There are lots of companies that sit outside the trade organisations, and one of the things that disappointed me was that perhaps the OFT should have more enforcement action to take against companies that are not providing the consumers with the best advice. I am pretty confident that consumers who are members of the trade bodies that are represented today will get the best debt advice out there. I think it is a shame that that was not really beefed up more because we have tried to assist the OFT over the last couple of years. We have seen companies behaving in a particular way that causes me concern and damages my business, and damages our sector. That cannot be good for anybody.

Chair: You have partly anticipated Rebecca’s next question, but if I can just bring her back in.

Q134 Rebecca Harris: At the OFT investigation, I think 129 of 172 commercial debt management companies surveyed were not compliant with industry guidelines. I would like your views on that, all of you. How much do you think commercial debt management companies should be more tightly regulated, and how?

John Fairhurst: I think it was a great concern that so many firms were found wanting. DEMSA and DRF have made good efforts and are making progress in addressing some of those concerns. Fundamentally, one thing the OFT did identify in that compliance review is that these are distress purchases. They do not shop around, they tend not to shop around on a particular price. They tend to look at the provider as someone who will give them good advice. They are not able to judge that themselves so the very highest standards should be applied here. And certainly our view is that trade body activities have been useful, but we need to go further. We need to have a truly vigorous, independent audit of debt management providers, not just to check they have been through all the processes and mentioned all the pros and cons, but to ensure that that advice is truly balanced. I do not think we are there yet.

Chris Davis: In some of the press releases that have come out, you can see the extra things that DEMSA have done, and I am sure Richard will comment on that. But I go back to my original point in the earlier question. Any person in any organisation that has a consumer credit licence who wants to operate in the field of debt management should be a member of a trade organisation; I would dearly like to see that, because that has to be in the best interest of consumers, but I am sure Richard will talk to you about the gains that DEMSA has made.

Richard Wharton: I think of the 129 the OFT found to be compliant, only one was a member of DEMSA. I stress that we are not here to defend the rogue operators in the market. We are here to speak for the reputable.

Q135 Chair: Did you say 129 were compliant?

Richard Wharton: Were non-compliant, I beg your pardon. We fully support the OFT’s debt management guidance revision, and we contributed to the consultation on providing the new revised guidance notes. In fact we suggested that they strengthen the guidance notes in particular areas, which I won’t go into in detail. As Chris has already said, we believe that the OFT should perhaps be given greater powers of enforcement. At the moment, if the Office of Fair Trading decide to put a minded to revoke notice on a consumer credit licence, it will take possibly 12 to 18 months for that to be finally sorted out with appeals, etc. And in that time the company can still trade. I think there perhaps should be a more immediate sanction that can be imposed.

Turning to John's point about independent audits, all our members are independently audited every year, and we have a schedule of other monitoring of their compliance, which includes quarterly web sweeps and desktop analysis of all advertising, and a consumer satisfaction survey where we aim to sample 10% of the total consumer base held by our members; that is done on a monthly basis. We have mystery shopping: we employ independent mystery shoppers to shop at the companies. We have a complaints-handling procedure and we have a beefed-up compliance and disciplinary panel under the chairmanship of Sir Harry Ognall, a retired High Court judge.

The independent auditing that John mentioned is currently undertaken by an outside independent body, Compliance Services. To take over this project with immediate effect, we have engaged the services of the ICAEW, the Institute of Chartered Accountants in England and Wales. I think there is one area where I would perhaps agree further emphasis needs to be put, and that is actually the protection of clients' account moneys held by companies. In DEMSA, we insist on a certificate from the company's auditors every year to certify that the clients' accounts have been handled in a proper manner. I think there should be more emphasis put by the OFT on that aspect. I think you all will have read in the papers recently about the organisation that actually took some clients' money away.

Melanie Taylor: Could I just add to a point John made? I think you referred to distressed purchasers. Related to what Richard was saying about the DEMSA customer satisfaction surveys that are ongoing each month, Gregory Pennington's satisfaction surveys actually came in at 86.8% from the customers rating the service either as good or excellent in the last quarter. So whilst obviously John makes a valid point about some of the less reputable providers, clearly these are customers that are valuing the service on an ongoing basis and actually feeling we are providing for them and meeting their expectations.

Q136 Chair: Right, okay. Can I just bring in Andrew Smith, who wanted to say something?

Andrew Smith: Thank you. I think the client account point is a very, very important one. DRF does not have the audit that DEMSA have, but I do not believe DEMSA's audit is adequate. We are making representations to the OFT about that, because what you actually need to do is assess that movements in and out of the account are still leaving sufficient funds to meet disbursements that are necessary for the client. Certainly there have been two debt management-related insolvencies this year, Debt Doctor and Apex. In both cases, if a much more stringent audit of the client account had been in place those would have been spotted, and the very large amounts of money that have been lost by clients would not have been lost.

Melanie Taylor: An addition to that, to strengthen it further, would be a requirement for compulsory insurance to cover the funds that are in the accounts.

Chair: Can I now bring in Paul Blomfield. Some of the issues have been touched upon.

Q137 Paul Blomfield: Some have, and there are some I would like to pursue further through written evidence. But I would like to put John on the spot for a moment. Why are you not a member of either DEMSA or DRF?

John Fairhurst: My earlier comment was that I did not feel that the standards were sufficient to ensure consumers received truly balanced advice. They may level the same accusation at me because we are not regulated by any trade body, and neither are any of the other free providers.

Q138 Paul Blomfield: Can I push you on that, John? In what way not sufficient? What would you be looking for?

John Fairhurst: I do have a degree of sympathy with these organisations, but there is a clear fundamental example, in that the OFT require people to give advice that is in the best interests of their clients, yet the advice for consumers in a DMP seems consistently to be to pay fees, including high set-up fees for that DMP, rather than going to a free provider whose services are available for free. There may be some rational reasons why the fee-charging service is better, but I have not heard them. I think this puts fee-chargers in a very difficult position; because they are not able to access the fair share model, they are not able, in my view, to give advice that is truly balanced.

Melanie Taylor: Could I make a point on that, please? Gregory Pennington have access to a full range of debt solutions, whether or not that is the debt relief order, which we are able to offer ourselves through approved intermediaries, or debt management or IVAs, which are payable by the client. Again, across Payplan, they are payable by the client in those circumstances. For the enquiries we receive, all our advice is completely free, so it is only if a customer chooses to actually take a service and employ us to provide that service for them that they would incur a charge. Only around 9% of people actually take up a service with us. We also host Debt and You, which is a free-to-client site that allows them to do downloadable budgets, gives them tips on managing their own money and allows them to deal with lenders themselves where they want to be empowered to self-manage. Our approach is very much about being able to offer the right solution to the customer regardless, which is why we offer the full range. So I think suggesting that because you are charging for a service means that you are not going to be balanced in your offerings is inaccurate.

Q139 Paul Blomfield: Do you have any further reflections on that, John?

John Fairhurst: I disagree.

Q140 Chair: Andrew, did you try to make a comment?

Andrew Smith: Yes, very quickly, the new debt management guidance that will come into force next year is policy following fact. For companies that are members of trade associations, advice is very definitely given on the basis of the client's need, and we monetise; we are able to take a fee, where it is appropriate that we offer a client a solution that we can charge for. The standards that DEMSA have already have OFT-code approval. DRF is well on the road towards achieving the first part of OFT code approval, and our standards have been written against the new guidance, which obviously DEMSA fulfil as well.

We have other requirements. For example, all our members must train their staff to the Certificate in Debt Resolution, which is 210 hours of study and three written exams, or to a similar standard. That is audited by our independent auditors. There are very high standards now in the members of the trade associations that are seeking to become trusted trade associations, and part of the self-regulatory system. We will certainly be inviting the non-fee chargers to play a part in DRF, and I hope that many of them will accept.

Chair: It is 12.20, and I intend to conclude proceedings at this point. However, we have half a dozen further questions that will be sent to you in written form, and we would appreciate your answers. Again, if there is any further information that you do not feel has been covered by questions, please send it in to us. Can I thank you very much for your contribution? I apologise that it has been abbreviated by the autumn statement. When we scheduled this session, we of course assumed that business would be carried out at the normal time.

Thank you for your attention.

Tuesday 13 December 2011

Members present:

Mr Adrian Bailey (Chair)

Paul Blomfield
Katy Clark
Julie Elliott
Rebecca Harris
Margot James
Ann McKechin
Mr David Ward
Nadhim Zahawi

Examination of Witnesses

Witnesses: **Tony Hobman**, Chief Executive Officer, and **Lesley Robinson**, Director of Corporate Services, Money Advice Service, gave evidence.

Q141 Chair: Good morning, and thank you for agreeing to answer our inquiries. Whilst I think you are fairly well known, could I just ask you to introduce yourselves for voice transcription purposes? I will start with you, Tony.
Tony Hobman: I am Tony Hobman. I am the Chief Executive of the Money Advice Service.
Lesley Robinson: I am Lesley Robinson, Money Advice Service, Executive Director responsible for our debt co-ordination programme.

Q142 Chair: Thank you very much. We are obviously time constrained. You will be asked a number of questions. Do not feel that you both have to answer every question if you feel that you have nothing to add. Can I just start off? It was put to us by Martin Lewis that MAS is just basically replicating what is already out there on the market, web-based debt advice, and that you spent all your time building up your brand rather than anything else. What is different about the service that you are providing from other existing providers?
Tony Hobman: When Parliament set us up last year, it was with a remit to help people better understand and manage their money, so very much in the preventative, generic advice space, not the debt advice space. The context of that was that there are low levels of financial capability and literacy in the UK, and there is a huge gap in provision. We know that something like half the adult population is unaware or unsure of where to get unbiased, free money advice.
Fewer than one in five people have someone they can trust to confide in about money matters, so there is still a huge gap in provision for our service, which is the preventative money advice service. In order that people know who we are, can trust us and use us, we have to market our services. It is only latterly that we have been asked to undertake the co-ordination role for debt advice for people in crisis, and that is a complementary but additional and different task.

Q143 Chair: Would it be fair to say that originally you were conceived as a pre-emptive financial education service rather than, if you like, a remedial service?
Tony Hobman: Yes, absolutely, in a nutshell.

Q144 Chair: But now you have had these other roles grafted on. To a certain extent I think the answer to that question pre-empts what would have been my next question. Given the fact that Citizens Advice is well recognised as a debt advice service, what are you offering over and above Citizens Advice, and why do you not just work through them?
Tony Hobman: Part of the answer is that we will work through Citizens Advice. The co-ordination role that we have been asked to undertake, with the support of all stakeholders in that debt advice space, including Citizens Advice, is a reflection of the fact that standards are uneven. The debt advice landscape is fragmented and people do not know where to turn. We can provide that objective overview and help work with those who do provide debt advice, including Citizens Advice, to come up with a more sustainable long-term model, including the funding for that. They do have a very good brand, and it is absolutely not our intention to subsume it or dilute it in any way.

Q145 Chair: I certainly can see the potential for having a greater degree of co-ordination. Can you elaborate a bit further on what you are looking to do?
Lesley Robinson: Sure. As part of the work we are doing, when we take this over in April 2012 our project is to develop a model of debt advice co-ordination that will be sustainable and build on the good practice that already exists in citizens advice bureaux and others. We are doing some research at the moment, as the Committee is probably aware, and there are a number of areas that we are looking at and working with our stakeholders on. We are very sure that there should be a single set of agreed outcomes for debt advice and that consumers should know where and when to get effective debt advice.
There should also be an effective triage process, where consumers can come in and be directed to the right sort of debt advice, and that should be multi-channel—a combination of digital, telephone and face-to-face services. There should also be a set of approved tools, so that the providers give consistent outcomes and there is an effective way of measuring that. Standardised data collection and the effectiveness of measuring outcomes are missing at the moment, and face to face will be part of that provision.

Q146 Nadhim Zahawi: Thank you very much. If I understand it correctly, you are just co-ordinating advice, or will you be providing both face-to-face and web-based advice?
Tony Hobman: In this preventative space, we are already providing advice across the web, telephone

and face to face. We already and will continue to hand people who use our services over and on to the debt advice advisers if that is appropriate. The more people that we see and the more successful we are in the preventative space, the more people we will not just route into the right debt advice community but in a sense prevent getting there in the first place, so in a sense we have a dual function.

Q147 Nadhim Zahawi: I understand that. You are providing advice as well as co-ordinating.
Tony Hobman: Yes.

Q148 Nadhim Zahawi: There is a problem with that, in the sense that you opened by saying that there is confusion already in the landscape of debt advice. Would you not just be adding to that confusion? You will be competing with the advice services already out there, including commercial debt management companies. Back to your point about building a brand, you are sending two different messages. You are either a co-ordinator or you are providing advice. The landscape is already confused. Are you not essentially adding to that confusion?
Tony Hobman: I do not believe so. Coming back to my earlier point, in any event we have this huge gap in advice for preventative money advice, and we need to fill that. The more successful we are at doing that, the less likely it is that people fall into the other camp. Having a high profile and being successful at one task does allow us to channel and route people more effectively than has been the case before.
We are at the early stages of developing this model, so we clearly understand that there are those risks of confusion. We absolutely do not want to add to the fragmentation and confusion that exists currently, so we will be working with all the stakeholders in the debt advice space to ensure this is not an issue, and that it ends being greater than the sum of the parts.

Q149 Nadhim Zahawi: If by the end of the process there is research to show that you have added to the confusion rather than helped it, would you then revisit your strategy?
Tony Hobman: Certainly we would, but I think the research we have already done has not highlighted confusion between generic advice and debt advice, just confusion within the debt advice community.
There are strong brands out there already. In fact one of the challenges, for example, with Citizens Advice, which has an excellent brand, is it is almost too well known. People will tend to head straight for face-to-face advice when that might not be the best means for them of being helped. They may be better off using the telephone or some form of self-help. That level of confusion far outweighs the possibilities or the challenge of some confusion between preventative advice and debt advice.

Q150 Nadhim Zahawi: If CAB is almost too well known, why not just utilise it? You mentioned that you were going to be working with them. Why not actually focus on that rather than trying to build a competing brand?
Tony Hobman: The brand that we are building we say is not competing, because it is a generic advice space. We are trying to help all of those who are in the debt advice space to channel their business more effectively. We know that something like 2 million to 3 million people actively seek debt advice at the moment, and the system has the capacity to help maybe only 2 million of those, and there is probably another 3 million or 4 million who have a latent demand for debt advice.
The real need is to ensure that people coming into the debt advice system are triaged more effectively, as Lesley said, than they currently are. Whether they first hit the phone button for Citizens Advice or to the National Debtline or CCCS or wherever, there is a lot that can be done in channelling that business, which means that the capacity will be greater.

Q151 Paul Blomfield: I wonder if I could probe a little bit more on the nature of the advice, taking up Nadhim's point. I held a roundtable of debt advice agencies in my own constituency, and one of the concerns that they have is that you have an over-optimistic expectation from the triaging process of the number of those needing debt advice who can be dealt with through web-based support. What is your assessment of that model in terms of the balance between web, telephone and face-to-face advice?
Lesley Robinson: It is interesting. As part of our ongoing research, the results of which will be published in the new year, a couple of things are coming through in our early findings. In terms of people who have used or would use face to face, the propensity to insist on nothing but face to face is actually very low. People are prepared to use other forms—telephone or digital.

Q152 Paul Blomfield: What is your assessment of whether they are right? When people get into debt, there is a level of wanting anonymity, but effective support can in many cases only be delivered face to face.
Lesley Robinson: Yes.

Q153 Paul Blomfield: What is your assessment of what people need rather than what they want in terms of appropriate support?
Lesley Robinson: That is exactly what we are currently looking at, the need point as opposed to the want point. I cannot give you the answer to that because that is still research in progress, but it is part of what we are looking at so that it can be measured and assessed effectively going forward.
Tony Hobman: I think our sense and indeed that of the debt advice community itself, from their experience of dealing with people through all these channels over a number of years, is that there is a case for a substantial rebalancing. I understand that something like only 150,000 people of those millions that we talked about are currently using any form of internet-based help. That instinctively feels far too low. There was a recent research study that asked a number of people how they felt about the face-to-face advice they had through the projects, and 25% said they would prefer to have been dealt with through

another channel. That is people who actually went through it, so there is a very strong indication that there is lots of leeway to change the distribution of channels.

Q154 Paul Blomfield: Could I ask one further question? Regarding your organisational model to support the sort of service that you anticipate you will be providing, I understand you are going through a restructuring process at the moment and shedding significant numbers of staff. Could you tell us more about that?
Tony Hobman: Yes, the restructuring at the moment is in relation to our preventative advice work; it has no bearing on the work we are doing in co-ordinating debt advice. We have a dedicated team led by Lesley doing that and will continue to do so. On the preventative side we have reviewed, as we said we would in this year's business plan, our own delivery channels, products and services so that we can reach far greater numbers of people more relevantly with the sorts of tools and services we think they need. So we are restructuring in order to fulfil that demand.
As I say, it has no bearing on what we are doing on debt advice, and we are maintaining our network of face-to-face advisers. We have over 100 face-to-face advisers across the country giving money advice. We have no plans to change that, and indeed we will be continuing with our telephone channel as well.

Q155 Paul Blomfield: Just on the restructuring in relation to core staff, it has been suggested that you are cutting from around 150 to around 20?
Tony Hobman: No, by no means. No, we are seeking to restructure from about 140 to 80.
Paul Blomfield: 140 to 80.
Tony Hobman: Not to 20.

Q156 Paul Blomfield: Okay, but nevertheless a very substantial cut. Are you confident that your deliver model is going to change substantially so that you are able to still provide the relevant services?
Tony Hobman: Yes, absolutely. I can assure the Committee that is the case, yes.

Q157 Nadhim Zahawi: How will you measure success? What are your KPIs for measuring success?
Tony Hobman: We are the first to admit that we have had fewer and less adequate ones than we would have wished thus far. We have not had the MI to report in some cases. We will be measuring both the use and reach of our tools as well as the underlying change in people's capabilities, so we will be doing a significant baseline research study next year to measure where people are or are not in terms of their financial capability. Then over time we will measure the difference between those who use our services and those who do not, hopefully to see a fundamental change in behaviour and mind set.

Q158 Nadhim Zahawi: We look forward to seeing that. You mentioned in your submission you were considering a levy on the credit industry to pay for debt advice. How will this work in parallel with the Fair Share model used by the Consumer Credit Counselling Service and Payplan?
Lesley Robinson: The first thing to say is we are obviously mindful of the existing Fair Share model, which has contributions of around £40 million a year, and there is no way that we are intending to displace that funding. In terms of the face-to-face projects that we are funding next year, that is additionality of service, with the services being provided in addition to those of the Fair Share model. It is not in any sense replacement or duplication, which I think is a key point. We believe that approach will complement, if you like, the work done by those providers funded by Fair Share, like CCCS and Payplan.

Q159 Nadhim Zahawi: Just on that point. What does "additionality" mean?
Lesley Robinson: Well, primarily the CCCS and Payplan are funding telephonic and digital channels.

Q160 Nadhim Zahawi: Which you are also doing, so it is replication of that.
Lesley Robinson: No, because what we are funding next year for debt advice is face to face as opposed to the preventative side.
Nadhim Zahawi: Right.
Lesley Robinson: The other point to make is that we have obviously been in consultation with existing stakeholders, including the larger financial services. They are fully aware of what we are doing and are supportive of it. They do not see funding the two as an issue.
Tony Hobman: We see next year as a transitional year, in that we are ensuring there is maintenance of the face-to-face work currently funded by BIS. What has been delivered thus far is in the order of 100,000 face-to-face advice sessions, and indeed we hope to increase that because we think more efficiency can be got out of the system, as well as the longer-term development of the co-ordination work and the advice model that we need to work with the industry to create.

Q161 Nadhim Zahawi: That is similar to the Payplan and the Consumer Credit Counselling Service in terms of the online and telephony stuff?
Tony Hobman: Yes, all of the other provision that is currently funded by Fair Share—the online and the telephone—will continue to be funded, as far as we are concerned, by the industry. There is no intention to displace or diminish that. We need to ensure the funding continues for the face-to-face work next year, which BIS is currently funding, as well as putting this long-term model for debt advice in place, which we hope to introduce with the debt advice community towards the back end of 2013.

Q162 Ann McKechin: Just very quickly, when you are talking about the debt advice community, is that solely the not-for-profit and charitable sector, and not the private, commercial debt-management companies in any way?
Tony Hobman: Yes, that is correct.
Lesley Robinson: That is correct.

Tony Hobman: We have an interest and a concern about that as you would imagine.

Q163 Ann McKechin: The levy idea would simply be the not-for-profit sector?
Tony Hobman: Yes, indeed, yes.
Lesley Robinson: Yes.

Q164 Mr Ward: Would your advice include referrals to debt management companies or not?
Tony Hobman: No, not the commercial fee-charging companies. As it stands, it would not. Under the model that is currently operated, where we do have concerns about the degree to which it is front-loaded, the additional costs for consumers and not least the fact that there are many absolutely suitable free alternatives, it is not something we currently see we would recommend to users of our service.

Q165 Mr Ward: They have defended themselves in terms of the justification for the charges and interest rates and so on, but you are still not convinced with those arguments?
Tony Hobman: Not yet.
Lesley Robinson: Not yet.
Tony Hobman: We see that there is more that could be done.

Q166 Mr Ward: You seem to be a more definite "no" than a "not yet".
Tony Hobman: We think there is a place for commercial provision, and we think there is a case for more adequate self-regulation. We have probably not seen it yet to the degree we would like. We welcome the OFT's efforts to be tougher on the sector and see how that pans out. I think that is important. There are a number of things that can happen that might make it a better place, not least that we help the free debt-advice community to have a much higher profile, so the consumers can see that is a better option for them in many cases in the first place.

Q167 Mr Ward: Your remit is for financially educating the population. How will you go about doing that? Obviously you cannot take on debts until you are 18, and yet a lot of preventative work needs to happen before then. How do you go about fulfilling that remit?
Tony Hobman: The work we do on the preventative side involves products and services that would be relevant for people all the way down to the age of 16, I would say, so absolutely at the point at which they are making a transition into the world, whether that is through further education or not. We do have and are continuing to develop a suite of tools that are relevant to them. We believe that all our products and services have an educative value, and, as I said earlier, the real task is to deal with the millions of people who are out there now in the world dealing with financial problems.
We do also have a significant interest in what happens in schools. We support the work of the APPG and the report that it issued. We also are now embarking on an important piece of strategic oversight to map all of the many initiatives—particularly those that the financial services companies have got going—in schools to understand what the longer-term benefits and worth of those is, where there are gaps and overlaps, as well as doing benchmarking of work around the globe and in other areas, such as health and drugs, to see whether there is anything to be learned from the programmes of work that have gone on there that can be crossed over into money teaching in schools. There is some important work we can do there to help in that educative space for young people as well as grown-ups.

Q168 Mr Ward: Will there be co-ordination, because you have not got many of the banks, off their own backs, who work in schools?
Tony Hobman: Indeed, yes.

Q169 Mr Ward: And with proliferation the danger is always the confusion. Will you be seeking to co-ordinate that?
Tony Hobman: Yes, absolutely. There is strong support. As you say, there is a lot of work done, often on the back of their corporate and social responsibility budgets, which is great, but it is true to say that there is duplication or there will be gaps, and we need to have probably more evidence of what the long-term value of some of those educational initiatives are. I do not think that really exists yet, and that is something that we are keen to do.

Q170 Mr Ward: What is your understanding of what is happening to the financial inclusion from debt advice services?
Lesley Robinson: In terms of the projects themselves?
Mr Ward: Yes.
Lesley Robinson: As you have gathered, we are funded and it is taking them forward next year to the full funding that they have had this year. But as Tony mentioned earlier, we are looking to try to increase efficiencies where we can and take some of the very best practice and spread it across the funds, looking to increase reach from around 100,000 to 150,000 as our target next year, but we are continuing to fully fund those projects.
Mr Ward: I think we have covered the face to face.

Q171 Chair: Yes, you said basically you will be referring people to not-for-profit organisations and so on, and working with them. Would you regard it as, if you like, a success if there was evidence that with-profit debt management companies began to struggle and even go out of existence, and do you think there is any possibility of that?
Tony Hobman: I certainly think that one of the most effective changes in the marketplace would be if the profile and the value of the not-for-profit and free sector was so clear to consumers that it became a natural first call for them. If as a result of that the market took its course, then that would seem to me not to be a bad thing for consumers.

Q172 Chair: Do you think that should be an objective?
Tony Hobman: Yes, I think that is fair to say. There is such a potential worth of the free debt-advice

community, so why shouldn't everyone ultimately be served by it if we can help to free up the capacity and manage the channels in the way that we have said we would like to?

Q173 Ann McKechin: Just one final question. It has been reported that your current salary is approximately £350,000 per annum. Would you wish to make any comment on that to the Committee?
Tony Hobman: A simple correction: it is £250,000 per annum, but there are some benefits beyond that. I believe that we have been tasked with something that, if we do it right, as we intend, will make a hugely significant difference to millions of people's lives. If we are successful, as we intend to be, I hope that all of the costs associated with that would be considered to be good value for money.

Q174 Chair: It is something like £100,000 more than the Prime Minister, which does seem a very large sum for what is, with the greatest respect, a relatively small organisation, albeit a very important one.
Tony Hobman: Then I feel hugely incentivised to do it well.

Q175 Margot James: Maybe I misunderstood something, but I find the distinction between preventive advice and debt advice rather hard to grasp; it seems to be rather a grey area. Are there not people who seek what you might call preventive advice who are already in debt? What would be the incentive for anybody who was not to even seek preventive advice, unless we were talking about schoolchildren, students and young people?
Tony Hobman: There is a demand for preventative advice, and that is part of the reason we have all of the tools and services available. Indeed, for example, we launched our new financial health check just earlier this year, and already 300,000 people have visited it. Clearly there is a need for people fundamentally to get their finances in order who are not yet in crisis debt. It is also true that people who may need help with some of the basics of, for example, budgeting or planning for the future, or indeed maybe meeting some particular life event that is giving them a financial issue, also need some form of crisis debt advice.
We are already able to pass them very quickly and straightforwardly on to organisations that can help them, such as Citizens Advice or CCCS or others. We can do the fundamentals first, and also be capable of passing people on to the specialists that they might need to see. As I say, this is for debt advice, but it could even be for more sophisticated financial advice, in which case there is the fee-based community as well.

Q176 Chair: Any further questions? Thank you. That was very helpful. We will monitor your progress very closely and may well see you again if we decide it is appropriate to do so.
Tony Hobman: Thank you, Chair.
Chair: Thank you, and we will call the next panel.

Examination of Witnesses

Witnesses: **Vivienne Dews**, Executive Director, and **David Fisher**, Director, Credit Group, Office of Fair Trading, gave evidence.

Q177 Chair: Good morning, and thank you for agreeing to come before the Committee. Could I just ask you to introduce yourselves for voice transcription purposes?
Vivienne Dews: Yes, I should say I have a slightly croaky voice; I hope I am not spreading too many germs around.
Chair: I think we are at a safe distance.
Vivienne Dews: Apart from my colleague, I think. I am Vivienne Dews. I am an Executive Director at the Office of Fair Trading, and my responsibilities include the consumer credit work.
David Fisher: I am David Fisher, and I am the Director responsible for consumer credit at the OFT.
Chair: Thanks very much. I will just repeat what I told the previous panel: you do not both have to answer every question, but obviously if there is something you feel you need to add to, please feel free to do so. I will open with Julie Elliott.

Q178 Julie Elliott: The Office of Fair Trading examined the high-cost credit market in 2010 and reported that in some respects the markets for high-cost credit work reasonably well. Do you think if that was repeated today the response would be the same, and particularly would the level of complaints from consumers still be low?
Vivienne Dews: We have seen the number of complaints go up since then. They are still relatively low compared with complaints we measure—the ones we see—but there clearly are more causes for concern in aspects of the high-cost credit market than there were at the time we did the review. That probably reflects the growth there has been in payday lending since that time.

Q179 Julie Elliott: What concerns you most about the high-cost credit market around its growth and the way it is operated?
Vivienne Dews: I think the key concerns fall into two areas. One is around transparency. A lot of it is around the very quick turnaround credit that we see more of, where credit is granted in 15 minutes or so, online or by text. We are concerned there about transparency. It is not a market in which consumers shop around a lot, and we are keen to be sure that they understand what they are buying, what they are getting, what the terms are—that they can compare the cost of products, particularly the total cost of credit. Very short-term credit probably gives them a better idea of what they are paying than an APR will do.

We are concerned about whether, in those quick turnarounds in particular, consumers are being given adequate explanation of what they are getting and whether the lender is assessing the affordability of the credit that is being granted and whether it will push the consumer into unaffordable levels of credit. It is in the light of those concerns that we are planning to do a compliance review in the new year of whether the high-cost credit providers are complying with the guidance we have on how high-cost credit or any line of credit should be granted.

David Fisher: I would just add one other point of concern, which is the point about forbearance. When people take out loans, as they sometimes do, and get into financial difficulty, we would expect the lender to exercise forbearance and make proper allowance for the difficulty that the person has got themselves into.

Q180 Julie Elliott: Do you think they are doing that at the moment or not?

David Fisher: The picture is mixed. We do still have some concerns in that area.

Q181 Nadhim Zahawi: What are you currently doing to monitor the marketplace?

David Fisher: We have quite an active monitoring role. It is essential that our information is as up to date as possible to allow us to make sure that when we are going to intervene in the market we are doing it on the best available information. We have a variety of sources of information that we use. Incidentally, we have fairly recently set up our own intelligence team.

Q182 Nadhim Zahawi: How big is that team?

David Fisher: It is about three or four people, part of a slightly larger policy team, so it is quite a small team. We will do a variety of things, and some of them may seem blindingly obvious to you. We will monitor the media. There is a lot of media coverage. We will engage with external stakeholders, for example consumer groups. We will look for research reports, which are obviously a very valuable source of information. We look at complaints and enquiries made to the Office of Fair Trading, which is another very useful source.

The final thing I would mention is that we look at complaints data on a regular basis. In particular we are looking at the complaints data to the Financial Ombudsman Service and to the Consumer Direct Service, which we at the OFT are responsible for running.

Vivienne Dews: It is just worth adding that we do not at the moment routinely collect detailed data on the total shape of the market.

Q183 Nadhim Zahawi: You do not?

Vivienne Dews: We do not, and we do not think that would be particularly useful for our enforcement work. But we did recommend, as part of the *Review of high-cost credit*, that we should start collecting that, and the Government has recently said it would like us to do so, and we will work with BIS.

Q184 Nadhim Zahawi: You do not think it is useful, but you are going to collect it.

Vivienne Dews: It is useful for policy development, but it is not particularly useful for individual enforcement cases against individual providers. The reason we have not collected it in the past is because there is a burden on businesses about seeking that information from them. But in the light of the *Review of high-cost credit* and the Government's response to it, we will work with BIS to work out how best to collect those data so there is a better picture of these markets.

Q185 Nadhim Zahawi: And the businesses are complaining that it is a burden on them to be able to provide those data for you?

Vivienne Dews: I think the concern that it was a burden was essentially our concern. There is a general issue that you do not want to impose undue information provision requirements on businesses unless there is a good reason for doing so. We concluded there was a good reason for doing so in these markets.

David Fisher: I think how important it is to gather the extra information depends very much on the sector that you are dealing with. As Vivienne has said, we have recognised and made the recommendation about gathering additional information in the high-cost credit sector. I think you make a good point about burdens on business, and it might be useful for you to know that we license something like 84,000 businesses; one-third of those are sole traders and something like two-thirds of them employ fewer than 10 people, so it is quite an important point to appreciate about the population, if you like, that we regulate.

We do have to think quite carefully about burdens on business and balancing that against the benefit that we think we will gain from requiring companies to provide this information. It is also perhaps worth noting that in this respect we operate under a quite different regime, for example, from the Financial Services Authority and the FSMA regime, where of course it is an essential feature of that that they do require companies to provide information on a regular basis. The Consumer Credit Act regime does not operate on that basis.

Q186 Nadhim Zahawi: How many of your recommendations made in 2010 have the Government taken forward?

David Fisher: In whole or in part, there are a couple of the recommendations that we made. I could check that, but one of them was the point that Vivienne just made there about gathering additional information. I think it is also worth remembering perhaps that, in making the recommendations following that report, we were very clear to specify that they were only intended to target certain of the features of the market that we found.

There were other fundamental issues with the way the market operates for high-cost credit that are completely outside of the OFT's remit, about which we could do nothing. You have been touching on one of them this morning, which is to do with degrees of financial literacy in the population as a whole, and yet another was to do with the provision and the supply of low-cost credit. Those are things that we acknowledge are major issues that the Government might want to consider how to tackle, but we are not in a position to make specific recommendations on how to address them.

Q187 Nadhim Zahawi: That was the second part of my question. Where do you think the Government should focus its efforts?
David Fisher: In that report we did specify those two very important areas where, if the market is to work more effectively than it does at the moment, you have issues both on the demand side, which is the ability of people to exercise influence in the market through their knowledge—through being financially literate—and we all recognise that is an issue across the country, and on the supply side, where there is the issue about where the supply of low-cost credit is going to come from.

Q188 Rebecca Harris: You have just touched on areas relating to Government, but in terms of your recommendations, where do you feel the Government should be doing more? Are you satisfied that the Government is doing enough?
Vivienne Dews: In relation to high-cost credit—I have just checked the figures—we made six recommendations in the *Review of high-cost credit*. Two were not accepted, two partly accepted, and two fully accepted by the Government. Obviously we made the ones that were not accepted on the basis that we believe that those were the right things to do, but the Government, I am sure, has taken wider considerations into account. Two were not accepted: one about a price comparison website, and one was about wealth warning statements on advertisements.

Q189 Chair: Why did they not accept them, do you know?
Vivienne Dews: I do not think I know, but presumably it would be for the Government to explain why they did not.
Chair: That is fair enough. The Minister is in next.

Q190 Rebecca Harris: My other question is about what might be seen as the nominal cost of obtaining a credit licence; a couple of our previous witnesses, Citizens Advice and Consumer Credit, raised this with us. At the moment it is £500. Pretty much anyone, provided you do not have an obvious criminal record, can obtain a consumer credit licence. There seem to be no greater checks on whether you are really competent to run a business, so it is not a lot of money in terms of being regulated for what can be quite risky businesses. I wonder if you have any comments on that, or whether you think the cost should be higher.
Vivienne Dews: There are two broad points there. One is that we do operate checks. We look at it on a risk basis, so the riskier the business that you will be involved in, the greater the degree of checking. So although it may be true that we do not perhaps apply a huge number of checks to the credit activities of some people at the very non-risky end, i.e. people delivering retail services, home improvements and so on, once we get into the riskier end, we are doing quite extensive checking, including through trading standards visits.
The other issue is about the level of resourcing of the regime. It is run on a self-funding basis. It has so far been run on the basis that we keep resourcing levels quite low. This is a matter that we agreed with the Government—to keep resourcing levels quite low. I think there is a debate about whether those resourcing levels should be higher, which would be met through an increased licence fee, in order that we could do more enforcement work. That is something that I think is a debate to be had with Government in the near future.

Q191 Rebecca Harris: I appreciate you said that many of these businesses were sole traders. For some of the larger companies, as a proportion of the business they are doing, £500 does not look very much to me, and there could be an awful lot in there that needs looking at. Are you recommending a change to that?
Vivienne Dews: Sorry, there is a third point, which is whether the fees should be differentiated.
Rebecca Harris: Yes.
Vivienne Dews: I think we consulted about that.
David Fisher: Yes.
Vivienne Dews: And then put that into abeyance, because there has been a broader debate about the broader future of credit licensing and where it sits within Government, so we did not pursue that at the time. We did not completely drop the idea, so I think there is a third point about more differentiated fees so that those who are at the higher-risk end, ones that essentially take more of our effort, might pay more money for their licences.
David Fisher: Just to build on what Vivienne says, I think it would be the case that all regulatory bodies would say, “If we had more resource, we could do more.” I guess that is rather self-evident. Vivienne has explained the checks that we do in what we call the gateway. You are right that much of it is about fitness, which is essentially a question of integrity—trying to test whether the people we are going to give grants and licences to have the integrity to operate in the market. As Vivienne also explained, we also check for the competence of businesses. Could we do more fitness checking and particularly more competence checking as well as enforcement with additional resource? The answer to that must be yes.
Vivienne also makes a really good point, which is that at the moment the fee is effectively one size fits all. The only differentiation at the moment is basically whether you are a sole trader or not. If you are a sole trader, it is roughly £500, and for any other kind of business it is roughly £1,000. Would it be helpful to us to differentiate fees according to the nature of your business and market, and in particular the level of actual or potential risk that you pose to people taking out loans and other related services? The answer to that is yes.
Vivienne Dews: The other point that is worth bearing in mind is that the current credit rating is relatively new. The rules changed in April 2008. As we are on a five-year cycle, licences come up every five years, we are still working through some of the people; some

people in the market had their licences before the current regime came in. Also there is quite a lot of developing with the new powers and abilities. We are still developing what we can do under the new regime, and learning how to operate the regime.

David Fisher: From 2008 to 2011, those powers the Government gave us did make a difference. They made a difference in terms of our ability to test competence and investigate companies, once licensed, that we have concerns about. They gave us more power to more proactively and effectively investigate those people: to visit them on their premises, to require them to provide information.

These are the sorts of powers that any effective investigation enforcement body really needs to have, so it was extremely helpful to us to have those additional powers. Some of those cases that we have been taking take quite a long time to work through, so that might help explain the comment about why it still feels to us like early days. You may think we have had these powers since 2008 and that is a lot of time, but the investigations can take a considerable amount of time.

Q192 Rebecca Harris: Presumably it must be better for some of the companies to find that they have been given a clean bill of health as well, which may impact on the ability to increase licensing fees.

David Fisher: Sorry, I did not quite understand that.

Q193 Rebecca Harris: In terms of increasing licensing, because it is partially in the industry's interest to be given a clean bill of health as well.

David Fisher: Absolutely.

Rebecca Harris: If the company has been told they have been looked at, and that it was fine.

David Fisher: I have one other point of clarification, if it would help, on the licence fee. As Vivienne said, it is a self-funding regime; therefore, we have to follow the Government's rules on such regimes. We set the fees, which are approved at ministerial level, to recover the cost that we expect to incur in delivering our responsibilities under the Consumer Credit Act. That is what we are required by law to do. We cannot set fees for any other purpose. For example, we could not deliberately set out to raise a fee on companies wishing to enter a particular sector simply to raise a barrier to entry, not that it is normally the OFT's wish to raise barriers to entry into markets.

Chair: That is a very interesting point. First Paul indicated, then David, and I have a couple of supplementary questions as well, but they may be covered.

Paul Blomfield: Take David first.

Q194 Mr Ward: On another area, there was the suggestion of a large-scale adult education initiative. I just wonder what that would look like. Who would deliver it? Who would pay for it? How would it recruit? We have obviously been looking at the inclusion of financial advice, awareness and dealing with money issues in the national curriculum at schools. But how do you recruit people to this large-scale education initiative?

Vivienne Dews: Sorry, which suggestion in particular are you referring to?

Q195 Mr Ward: The one that I believe the OFT have made about this large education initiative.

David Fisher: To be clear, we did not make a specific recommendation on that. That was one of the underlying issues affecting the market that we said was specifically outside our remit. That was the point I made earlier about what we call on the demand side not enough people being financially literate. Our observation in the report about that was there is clearly an issue here that needs to be considered, but because that is completely and utterly outside our remit, we did not make a specific recommendation on it.

Q196 Mr Ward: It just seems, amongst a list of others, as being quite nice to do, but I just wonder about the deliverability. A cultural change in society and individual consumers' approach to credit. Yes, but how?

David Fisher: Again, exactly—that is the question to which the OFT is not in a position to give a specific answer.

Vivienne Dews: This is from the *Review of high-cost credit*. What we made clear was that a lot of the issues were well outside the OFT's remit—the issues around credit and debt. So there were things within the market we could and did comment on, but many of the things that concerned people were not within our remit.

Q197 Mr Ward: They may not be within your remit, but unless they are addressed, how many of the things that are within your remit will be successful?

David Fisher: We see the low levels of financial literacy. At the OFT with our responsibilities we actually see the effect of that. We see consumers being disadvantaged by, sometimes, unscrupulous businesses providing them perhaps with loans that are not suitable for their needs, and consumers making choices without being fully aware of the implications, and in particular without being aware of the risks that they are potentially entering into. We see the evidence of that day to day in the investigations that we do and the enforcement action that we seek. That experience would suggest to us that any successful attempts to raise general levels of financial literacy would inevitably have a beneficial effect on that. The initial question that you raise about how one would go about doing that is something we are not in a position to answer, but we would expect to see the beneficial effects of that.

Q198 Mr Ward: I suppose what I am trying to delve into is how crucial these things are. Many things could be done, but what is the most important thing that needs to be done? You are suggesting that you are capable of doing many things, but how successful will they ultimately be when there is still this massive gulf in knowledge, experience and understanding of the system?

Vivienne Dews: Clearly, were there much higher levels of financial literacy, many of our efforts would be much easier, but we have to work within a system in which it will take a long time to bring financial literacy up to a reasonable level. As David says, a lot of the issues we see are indeed the result of not very good financial literacy in the population. That probably goes right back to quite early days. We play quite a small part, in that we produce the material for schools, for teachers, called *Skilled to go*. That is primarily about general consumer issues, but it does have a small section on financial literacy. We certainly would not hold ourselves up as being a key player in trying to improve financial literacy among the population.

David Fisher: We are a relatively small organisation with a fairly clearly defined remit under the Consumer Credit Act, and frankly we have to focus the resource that we have in delivering that remit as efficiently as effectively as we can. Largely we are doing this on behalf of vulnerable consumers.

Q199 Paul Blomfield: If I could just probe a little bit more into your review of the so-called industry. In the roundtable of debt agencies I mentioned earlier that I had in Sheffield, I was quite shocked by some of the practices. One adviser told me that he had dealt that morning with a case where the high-cost credit company, because they had the debit card details of his client, had taken £800 out of her account without any consent or notice, leaving her unable to pay rent or fuel bills. I was shocked by that, but all the other advisers around the table nodded as if this was common practice, and indeed said it was. I am surprised that sort of area perhaps is not one that is featured in your review.

Vivienne Dews: It is one we are seriously concerned about. I assume that is something like a continuous payment authority. We have a section in our *Debt Collection Guidance* that makes it clear that essentially is unacceptable practice. That has been challenged by the industry, and as a result of that we are going to launch, probably in a few days' time, another short consultation on this practice. We will use that in order to draw more attention to the unacceptability of that type of practice. But essentially, if people come across complaints like that, they should tell us, because we do monitor complaints data, so telling us that is happening enables us to take enforcement action.

David Fisher: You were surprised that it did not appear in the *Review of high-cost credit*. The report that we were doing then was the totality of the market. It was a very macro view of this market and how it works. From that we have developed various initiatives. What did it tell us, and what have we done about it? Obviously it highlighted some issues of concern. Vivienne has referred to the fact that we have issued the *Debt Collection Guidance*, which draws upon a previous piece of guidance that is crucial to everything that we do in terms of setting standards, which is what we call our Irresponsible Lending guidance, which sets out the minimum standards that we expect of companies operating in the market.

We have a number of very specific concerns, one of which is misusing continuous payment authority. Vivienne is right; that is what you are talking about. Continuous payment authority itself is a perfectly legal thing to do. Like so many perfectly legal things to do, it is how you then use it. We really do have concerns about misuse of continuous payment authority, which effectively comes down to creditors dipping into your bank account, sometimes many times in the day, and taking out sums of money that they may not have agreed with you and at times that you might not have agreed. I am sure the adviser and others would have told you that they can find consumers, quite literally on occasions, left with nothing in their bank account, so how do they go shopping that day and how do they pay their electricity bills? Misuse of continuous payment authority is a concern for us.

Others include, and we have mentioned some of them before, not carrying out appropriate affordability assessments. We regard that as irresponsible—to be lending money without properly checking that somebody is capable of repaying it. We regard things such as continuously rolling over loans as another example of irresponsible lending.

The interesting thing about these things is it is not the practice per se. You can use continuous payment authority in a perfectly legitimate way if you are a responsible business. You can roll over a loan in a way that can be perfectly legitimate and responsible. When you step over a line—when you misuse that authority or you continuously roll over loans in an irresponsible way—that is what we are after, and that is what we look for the evidence of. It is companies that do that we set out to target.

Q200 Paul Blomfield: Perhaps, although it is a perfectly legitimate process, it is not appropriate for this sector. The idea that such vulnerable clients are exposed to these sorts of companies dipping into their bank accounts as and when they need to, taking out unmanageable sums of money, is perhaps an area that goes beyond guidance towards regulation. Would you have a view on that?

Vivienne Dews: No, we would not accept that it is not appropriate for this sector. If somebody takes out a loan, setting up an arrangement to repay that loan is an absolute—

Q201 Paul Blomfield: With a manageable sum over a manageable period.

Vivienne Dews: Indeed.

Q202 Paul Blomfield: As opposed to dipping in unauthorised without notice.

Vivienne Dews: We are absolutely against the unauthorised dipping in, and that is something that we will take action on if companies are doing that. But the principle of an authority so that the money is paid over on the agreed basis is perfectly legitimate.

Q203 Paul Blomfield: That could be provided through a standing order, which does not then provide the company flexibility.

Vivienne Dews: Yes, they can be set up in different ways, but if a continuous payment authority is used correctly simply as a means of making the agreed repayments, we do not have an issue with that. We do have an issue if it is used improperly to take money at times when it has not been agreed and without proper authority. We draw quite a distinction between proper use of it and improper use of it.

David Fisher: We have already taken action against two payday lenders regarding their misuse of continuous payment authority. In both cases we imposed requirements on them, the essence of which was that they could use this authority only as agreed with the person to whom they had made the loan. So you can only recover the amount of money that has been agreed with that individual, and you can only recover the money on the day of the month that has been agreed. If you wish to change that in any way, you have to get the prior agreement of the consumer to do that, so we have imposed requirements on a couple of companies already.

Q204 Paul Blomfield: Thank you. I will move on to a different area, which is debt management companies. Your review of debt management companies was taken out because, even though you had made recommendations, the industry was not responding as you had hoped. Is it now responding to the findings of your review of those companies?

Vivienne Dews: They are continuing to work with us. A very significant number of companies left the market following that review. We are or have visited all the other companies who are working in that area. Some of the trade associations are doing some good work in trying to bring up the standards. I do not think we would say that we are yet completely happy, but yes, we do see significant improvements following the work we did.

David Fisher: We will be updating our guidance on debt management in the new year. I sometimes find that people perhaps think the name “guidance” is a bit of a misnomer. We call it guidance because that is what the Consumer Credit Act calls it. It is more than guidance. It is not soft law, as some people call it. It is not a rule, as the FSA are capable of doing, but it is effectively setting out to businesses the minimum standards that we expect of them, and we illustrate it with examples of business practices that we would regard as irresponsible and that go to the question of whether they are fit to hold a consumer credit licence. So we make it very clear to industry that we expect them to comply both with the letter and the spirit of the guidance. If they do not, and we have good evidence that they do not, we will take that into consideration when we are considering asking ourselves the question, “Does this company remain fit to hold a consumer credit licence?” be it as a debt management company or any other in the sector.

Q205 Paul Blomfield: In the context of that explanation, it was extraordinary that 129 out of 172 debt management companies were actually breaching your guidance.

David Fisher: Yes.

Q206 Paul Blomfield: Could you perhaps explain to us a little bit more about what you are now doing in terms of remedying that situation and monitoring their performance?

David Fisher: Vivienne has partly touched on that. As you rightly say, we warned 129 firms, which was a very high proportion of companies operating in the market at that time. Frankly we would be the first to say how very, very disappointed we were to discover how little credence seemed to be given to the guidance. But what did we do? We took rigorous enforcement action, and I think you have already quoted the statistic; I think something like 53 companies exited the market immediately following that as a result of the work that we were doing.

Q207 Paul Blomfield: Was that a voluntary exit from the market or was it because you revoked licences?

David Fisher: It is a mix. Quite a surprising number you might think—a large number of them—voluntarily exited before we would take enforcement action against them. Frankly I can only deduce from that that they saw what was coming. Some of them did not volunteer to go gracefully, if I can put it that way, so we took enforcement action against them. That was the 53. Since 2010 a further 17 have exited the market as a result of enforcement action or as a result of us not letting them into the market in the first place.

The next step is the revised version of the *Debt Management Guidance*, which will come out in the new year, which will very explicitly pick up on some of the concerns that we identified with the review. That will set a new and even higher standard that we will expect people to comply with. If we find evidence that businesses do not comply in any significant way with that guidance, we will take enforcement action against them.

Q208 Paul Blomfield: I do not have the sum in my head, but there are clearly a number of companies that previously breached your guidance that are still in the market. Are you worried about their performance now? What are you doing to monitor their operation?

David Fisher: We imposed requirements and conditions on a number of companies, and part of our remit is to monitor their compliance with those requirements. If they comply, as some of them will for sure, then brilliant. But if we find evidence that they are not complying with those requirements, we will take appropriate enforcement action.

It is perhaps worth making the point that we have to try to tailor our actions to the seriousness of the concern that we have. We also are very much driven by how a company chooses to respond or not to respond to what we do, and we have various ways that we can deal with companies. We can sit down informally and talk with them about our concerns to see whether they will agree to change their business practices. We can escalate it and we can impose requirements upon them.

We would be particularly concerned if a business subsequently disregarded an undertaking to behave differently they had given us or we had imposed on them. That would go straight to the heart of the crucial question for us: “Are you fit still to hold a consumer credit licence?” The next escalation, frankly, is a choice: we can impose a financial penalty if they disregard a requirement, or we might just choose to go straight to action to revoke a consumer credit licence.

Chair: Could I ask you to try and keep your answers as concise as possible. We are running out of time and we have some more questions.

Q209 Paul Blomfield: This is my final question. On that point that you were making, you have been criticised because of the time that it takes to revoke a licence. One of my colleagues made the point in the very fine partisan debate we had in the Chamber a couple of weeks ago that it can take up to two years. Would you like to have more powers to be able to suspend licences more quickly?

Vivienne Dews: Yes, is the short answer.

Q210 Ann McKechin: As you will be aware, the Government has put a high priority on self-regulation rather than introducing further legislation. Given that self-regulation would often mean a reduction in profits for debt management companies, what do you think the incentive is for greater self-regulation as opposed to statutory controls in terms of this sector of the industry?

Vivienne Dews: The debt management companies are subject to the statutory controls in the form of the Consumer Credit Act and the regime we run. I do think that the self-regulation and the trade association regulation is very helpful in terms of improving the standards in the industry. We work with the trade associations as well as the individual companies to bring the regulatory standards up. Our concern is about getting standards to the right level, using all the levers that are available to us.

Q211 Ann McKechin: There has been some criticism about the lack of competition, because consumers do not compare one type of debt management company with the others, and the charges can be very opaque. Do you think that debt management companies should be forced to produce figures, for example the number on debt management plans, the average payments, so that people can ultimately get some feel for the level of services available to them?

Vivienne Dews: I think the key thing is that the individual consumer should be able to see what they are paying and what they are getting for it, and should be able to compare what they are getting from one company to another. You are absolutely right that this is not a market in which you can shop around; it is possibly even worse than high-cost credit in that people do not shop around in this market. They may feel uncomfortable with the stigma associated with it, so our concern is absolutely about transparency of what they are paying and what they are getting from the company.

David Fisher: It is a classic distress purchase in debt management.

Q212 Ann McKechin: Can I just ask another very quick question? It was raised in some of the evidence we have heard about the differences that are applicable in Scottish law in terms of voluntary settlements with creditors, and people thought that the solution in Scotland that was used for debt management plans was preferable to that which applies south of the border. Do you have any reflections on that?

David Fisher: I am afraid not. It is different.

Vivienne Dews: It is not something that is known to us.

Q213 Chair: Just going back to the issue you raised about the cost of a licence and the number of licensees that you have to monitor, do you not think there is a case for raising the cost of a licence? Because you do say, in effect, if you had more resources you could do more to monitor. Therefore, given the huge number of companies that you have to monitor, and inevitably you cannot be as intrusive as maybe you should be on them, and the low levels of entry, is there not a case for raising the cost of entry to give you more resources to monitor more effectively those that are still left in the market?

Vivienne Dews: There is certainly a case, and we are already starting to discuss with Government where they want to set that level. At the moment the regime is run very much on a "keep the costs low" basis. That may no longer be the right way to run it. There have been changes in the market over recent years, and it may be that more resources so that we can do more enforcement work would be the way to go. But that is certainly not something for OFT on its own; it is something that we would like to talk to Government about, and the decision ultimately will be taken by Ministers about how they want to see that balance between keeping the cost down and maximising what we can put into enforcement.

Q214 Chair: If you could take a piece of regulation off the shelf to help you do your business, what would be your priority?

Vivienne Dews: The thing we would most like would be the power to suspend a licence. I am not sure that is quite what you meant, but if we were looking at how we could increase our powers, that would be top of our list. It has been discussed with Governments in the past. I do not think there is any debate about whether it would be a useful thing to do; there has not been an opportunity to give us that power, but there is no real debate about it.

There are some other less clear things we would be interested in. For example, the power to ban a particularly harmful product would be one of those. Those and the point about resourcing would be the key points we would make.

David Fisher: Possibly a regulatory redress scheme of some sort. For example, the FSA have that within their remit, and we do not. That might be another example.

Chair: Interesting. Thank you very much. That was very helpful, and we will incorporate your information and preferences into our report and maybe our recommendations as well. Thank you very much.

Examination of Witnesses

Witnesses: **Edward Davey MP**, Minister for Employment Relations, Consumer and Postal Affairs, **Nick Howard**, Deputy Director of Policy, Insolvency Service, and **Kirstin Green**, Deputy Director for Consumer Credit and Empowerment, Department for Business, Innovation and Skills, gave evidence.

Q215 Chair: Good morning, Minister, and welcome back.
Mr Davey: Yes, it is great to be back again, thank you.

Q216 Chair: Could you introduce yourselves for voice transcription purposes?
Nick Howard: My name is Nick Howard, and I am Deputy Director of Policy at the Insolvency Service.
Mr Davey: Edward Davey, and for this session I am the Consumer Affairs Minister.
Kirstin Green: I am Kirstin Green. I am Deputy Director for Consumer Credit and Empowerment at BIS.

Q217 Chair: Thank you very much. First of all, the new Financial Conduct Authority. Where is it going?
Mr Davey: We are still analysing all the responses to the consultation and working closely with the Treasury, and we will be announcing our response early in the new year. I am afraid I cannot pre-empt that here today, Chair.

Q218 Chair: Okay, how early is early?
Mr Davey: It has not been decided, but I expect it will be January or February. But it is a very important part of the jigsaw, so I understand why you would want to raise it.

Q219 Chair: Yes. Just on another issue, you may or may not be aware of this, but the salary of the MAS Chief Executive was quoted earlier on at £250,000 plus benefits. In comparison with the Prime Minister's salary, does that not seem somewhat excessive? How did you arrive at that figure?
Mr Davey: It has not been a decision from BIS. As you will know, the budgets for MAS are set by the FSA and they are responsible to the Treasury via the FSA. We are just consulted on their budgets. But you will know, from evidence the Secretary of State has given to this Committee, that in BIS we are concerned about high salary levels, both in the public and private sector, and we would urge restraint at that sort of level, for sure.

Q220 Chair: Did you urge restraint?
Mr Davey: Well you started off your question asking whether I knew about it. I was not involved in the setting of it. All I will say is that it is quite a high amount, and I am sure the Financial Services Authority and the financial services industry will be wanting to look at it.

Q221 Chair: Thank you. Can I just go on? Debt. There are increasing numbers of people in unmanageable debt. What do you think are the main reasons for it?
Mr Davey: We have seen over a period of time a huge growth in consumer debt. It is now I think about £1.4 trillion. While most of that is secured, we still have a lot of unsecured debt as well. I think that is partly because there has been the ability for people to lend in our liberalised credit markets.
The reasons, I would guess, are beginning to change. There may be some people now who are borrowing because they are under financial pressure. There will be a myriad of reasons, but we have seen a big trend of increase, although I think the rate of increase and the composition will no doubt change again. We need to be worried that there could be particularly vulnerable consumers who are exceedingly financially constrained and are having to rely on credit.

Q222 Chair: Yes, absolutely correct. Of course we are coming up to Christmas, when vulnerable consumers are under most pressure. Is the Government planning to act to discourage people from taking on unmanageable debt at such a time?
Mr Davey: We do have a view that people need to decide what they are going to borrow themselves, and it is not the Government's job to go in there and tell people, "You should borrow this, and you should use this product or that product." I think in a free society it is important that people have freedom and choice. Of course, through a lot of our work and the work with many other people, we wish to try to improve information and improve the overall financial literacy of the nation.
That is why with the last Government, the cross-party agreement got into law what was then called the Consumer Finance Education Body and now the Money Advice Service, who I know you have spoken to to develop that side of the equation, but it also very important that organisations on the frontline, whether it is Citizens Advice or others, are also able to provide advice and information.

Q223 Chair: I accept that it is a dividing line between, if you like, the "nanny state" and so on, but the Government does introduce a whole range of public information or public warnings over a whole range of issues. In view of the significance of Christmas, the pressure it brings on people and the consequences of not handling it correctly, is there not an argument for some sort of public information campaign that would at least, shall we say, inform and advise people?
Mr Davey: There will be a number of campaigns over this period. There is one that will be launched targeting young people to make sure that they understand the issues of managing their debt, because there has been a rise in the number of young people getting debt relief orders, so we have taken that part from statistics, and working with a number of organisations, including Citizens Advice, that campaign will be going. There is also an Illegal Money Lending project Christmas borrowing campaign, to make sure that people are aware that

they should not go to illegal money lenders—people who are not licensed, the loan sharks.

Q224 Chair: Do you know when these are rolling?
Mr Davey: I think they are rolling very soon.

Q225 Chair: Given the proximity to Christmas, they need to be.
Mr Davey: They are Christmas-related campaigns.

Q226 Paul Blomfield: When we met Martin Lewis he talked about the UK market in this sector as being "a crock of gold at the end of the rainbow for payday lenders who have been shut down all over the world", and he talked about us as the unregulated Wild West. Are you concerned about the proliferation of payday loan companies? I am guessing that you probably are, and I should not prejudge your answer, but what are you going to do about it?
Mr Davey: I have a huge respect for Martin Lewis. The work that he does is highly regarded not just by Government but many people out there. I think to say that the sector is unregulated is not quite true, because we have the Office of Fair Trading, who have taken action against payday lenders.
But you asked whether I think this is an area that we should be worried about, and the answer is yes; we should be worried about all aspects of high-cost credit, not least because they tend to be used by more vulnerable consumers. Our approaches, whether it is looking at regulations, codes of practice or other ways of getting competition into the market and so on, are all designed to try to make sure that we improve the overall options and experience for the consumer.

Q227 Paul Blomfield: When we met with one of the representatives of the industry—I cannot recall who—they described the UK market as still relatively immature. The more mature market in the US has decided that regulation is the way forward, so why are you not inclined in that direction at the moment?
Mr Davey: First of all I would say that there are regulations.

Q228 Paul Blomfield: For example, regulation to cap total levels.
Mr Davey: You will be aware, following our review and call for evidence, there were an awful lot of people suggesting that we looked at a cap on the total cost of credit. The previous Government had looked at caps on interest rates three times, with the OFT research, the Competition Commission research and a review done by Policis, and they came to the conclusion that putting a cap on interest rates had a real danger because it might push consumers into the hands of the loan sharks, the illegal money lenders. So the previous Government did not pursue that.
But this idea that came up and was pushed both in Parliament and outside Parliament of a cap on the total cost of credit had not been researched before, so we decided to commission some research on that, and we announced recently that Bristol University's Personal Finance Research Centre will be looking into that and reporting next summer.

Q229 Paul Blomfield: Next summer? Could you give us a more precise indication?
Mr Davey: I think it is down for July. I have asked them to give us an interim report halfway, because I know there is a lot of interest in this.

Q230 Paul Blomfield: That is helpful. Will you be able to share the interim report with us as a Committee?
Mr Davey: Whatever we get from their interim findings, I am very happy to share, but obviously it will be the major report when it is published that I am sure you will want to look at.

Q231 Paul Blomfield: Can I just ask about a further aspect of potential regulation, and that is the concern that there is about the way that loans are rolled over? Again, in the States one of the legislative interventions has been to prevent rollover of loans, which gets people into this spiral of credit and zombie loans. What is your view on that sort of area of Government intervention?/p>***Mr Davey:*** We have concerns. Again, I should go back to OFT, because it does operate in this market. As I am sure they will have told you, they have Irresponsible Lending guidance, and they are going to do a compliance review next year and I think they will be targeting the payday lender market. I think they have made it clear that, if they find non-compliance with their Irresponsible Lending guidance, they will be enforcing, as they have done in the past.
In addition to that, we are now engaged in intensive discussions with the four associations who represent over 90% of the payday lending market to see whether or not through codes of practice we can have significantly enhanced consumer protection. I have written to the associations and I intend to meet them. I am making a very clear signal to them that some of the practices that I think you are referring to, whether it is the rollover, the continuous authority, irresponsible advertising or a need for greater transparency, all need to be addressed in codes of practice.

Q232 Paul Blomfield: If they were not addressed to your satisfaction, would you be prepared to regulate and legislate?
Mr Davey: I always believe that you should try the non-regulatory route first, and I believe codes of practice can work. But I do remind you that there is regulation in this sector, and obviously, as we look at the consumer credit regulation regimes as a whole, as the Chairman reminded the Committee we are doing at the moment, one of the issues we will be looking at is the power and resources for the consumer credit regulator.

Q233 Nadhim Zahawi: Will you be introducing a new measure, Minister, other than the APR, to help people to understand and compare payday and high-cost credit deals?
Mr Davey: We have no direct plans to regulate to force payday lenders or indeed any other lenders to have new measures, but I think there is a very good and healthy debate about APRs because they can often

not be the most informative measure of the cost of credit. Indeed, some lenders talk about the total cost of credit to make sure that people understand that if, for example, they borrow £100 from a payday lender, in five days' time they will pay back £110. I am afraid I cannot remember what the APR would be on that, but it is thousands of per cent.

Q234 Nadhim Zahawi: Pretty big.
Mr Davey: Pretty big. But they probably would not generate much business if they said, "There is a 3,000% APR on this."

Q235 Nadhim Zahawi: He put it in terms of pints of beer that you would buy a friend to thank him with.
Mr Davey: Yes, Martin Lewis is very keen on that anecdote, but given that we discussed pubs last week, I would not want to go back.

Q236 Nadhim Zahawi: Very well. Your suggestion for the payday loans market is self-regulation. We have heard from Consumer Focus that previous attempts at this have been unsatisfactory. What is new in the Government's proposal?
Mr Davey: I am going to be like a stuck record, I am afraid. There is regulation in this sector. It is conducted by the OFT. I know others would like to see the OFT have more powers, and one of the themes that has come out in our consultation on the Consumer Credit Regime is that some people wish the consumer credit regulator to have more resources too. So I am pushing back, I am afraid. There is regulation in this sector, but the question is whether we need to give the consumer credit regulator more powers than it has at the moment.

Q237 Paul Blomfield: You are talking, Minister, about the role of the OFT, a point you have made with some regularity. The OFT carried out a review of the sector and made two recommendations, which, from my experience of talking to debt advisers, would have been extremely helpful because of the problems of comparing various products in the market. They called on the Government to look at introducing legislation to create a single website to allow consumers to compare home credit, payday and pawn broking loans, and also to look at high-cost credit wealth warnings. I understand those are two recommendations you rejected. Why?
Mr Davey: I think the proposal on the website came from the Competition Commission's inquiry into credit.

Q238 Paul Blomfield: No, it was from the OFT.
Mr Davey: I just want to make sure that I am answering in the right sphere here, but I am advised that the Competition Commission's remedy for the problems it saw in the home collected credit market was that a website be set up, and I believe that is actually active and working, but maybe we are talking at cross-purposes.

Q239 Paul Blomfield: I think there is a difference between the website you are referring to and the OFT recommendation, which was for a website with comparative loans across the whole sector, not just home loans, including the high-cost credit sector. And you rejected that recommendation.
Mr Davey: I think one of the issues here, and it also goes into the wealth warnings, is first of all there is quite a lot of information out there now that is very easily accessible about the different costs and comparisons. I am sure Martin Lewis would have referred you not only to his own website but to others that do give price comparisons.
I hear the point on the wealth warning, but let us remember that it was only in February this year that the Consumer Credit Directive came into force, and that had a number of measures in it, putting new requirements onto lenders, giving consumers new rights in these markets. They included: "Lenders will have to make a reasonable assessment of whether a borrower can afford to meet repayments in a sustainable manner"; "Lenders will have to explain the key features of the credit agreement to enable the borrower to make an informed choice"; and "Prospective borrowers will be given an information sheet setting out all the relevant information…in a standard format for all lenders, so borrowers can easily compare the costs of different loans." That is an actual regulation in this area that is already there. Of course, one can always introduce new regulations, but this is a pretty recent regulation, only coming into force in February this year.

Q240 Rebecca Harris: The Government places quite a lot of emphasis on credit unions. I just wanted to know what you are specifically able to do to create an environment in which they will flourish, and what your vision is for credit unions?
Mr Davey: I must be slightly careful, because I do not have ministerial responsibility for credit unions, but I will try to answer the question. You will know that the Department for Work and Pensions is undertaking a study on credit unions. It has set aside £73 million to invest in the credit union sector over the spending review. Before it decides how it wants to spend that money, it wanted to do a feasibility study to work out the best way of trying to enhance and develop the credit union sector. I think that is the right thing. I have not seen that report, it is not yet published, but I am very much looking forward to it.
I certainly engaged with Lord Freud, who is the Minister responsible at DWP, wearing two hats actually; the first was the consumer credit hat, because I think the role of credit unions is very, very important in this space. I think it could have a very significant impact if we can enhance, develop, widen and grow the credit union sector, because I think as a not-for-profit competitor in the high-cost credit market, it could give some of the other high-cost for-profit lenders a real run for their money. I would really welcome that, and it would be a competition response to the problem, so I am looking forward to their report in that regard.
Wearing another hat, which is the Postal Affairs Minister's hat—I would love to come to talk to you about the Post Office some time, Chairman.

13 December 2011 Edward Davey MP, Nick Howard and Kirstin Green

Q241 Chair: You may well have an opportunity very shortly.
Mr Davey: I am looking forward to that. But I personally see a role for the Post Office network to help credit union expansion. I cannot say that is what the report will recommend, but it is no secret, and I have said it in the House, that I see a potential role for the Post Office network.
One of the issues about credit unions is that people are not aware of them as an option. They also have real problems transacting and being out there for people to access. If you could access credit union payments over the Post Office network, and they were there and able to advertise credit union products, I think it would be the biggest shot in the arm imaginable for the credit union sector. When you look at other countries, credit unions play a bigger role there. I am sorry this is a bit of a long answer, but I do feel passionately about this. I am not sure if I am giving the vision you wanted, but I do believe this is an area into which we should go.
What really struck me was when I was talking to one of the Illegal Money Lending teams who are cracking down on the loan sharks, the real criminals that cause so much misery to people, was that they gave me an example of how—

Q242 Chair: Could I just say we are coming on to illegal loans.
Mr Davey: Okay, I will just summate then, and I will give you the full monty when you come back to it. The people who they helped had been harassed for 10 years by the loan sharks, had gone through misery, and they were not aware of the credit union option. Now that they have got themselves on the straight and narrow again, having been helped by the Illegal Money Lending team, they are accessing credit via a credit union, and their lives have been improved immeasurably. So I think the role of credit unions should not be underestimated.

Q243 Rebecca Harris: One of the specific suggestions made to us by the credit unions is that the other credit providers should have to highlight their availability in their advertising. Obviously to enforce this would require legislation, but are you in favour of that as an idea, and how could you promote it if you were?
Mr Davey: I have not heard that before. I have met ABCUL on at least one if not two occasions to talk about this Post Office scheme, and I would like to see what the DWP report says. I think what I want most of all, the more you look at the different problems in the different markets—I think this is really important—is for people to be made more aware of the not-for-profit competitors or the free debt advice competitors, and they need to be more accessible. I think pursuing those sorts of policies is really important to dealing with consumer detriment in this area.

Q244 Ann McKechin: In terms of alternative forms of finance other than payday loans, we have obviously talked about credit unions, but I think there is some acceptance that credit unions are still a very small percentage of the entire market. You mentioned about issues around Post Offices. I just wondered if I could tease out whether you think Post Offices and Post Banks should be offering these types of services to consumers at a more affordable rate. If they cannot get access from their banks to that type of lending, do you think that would be an alternative? I do not think anyone can be comfortable about payday loan shops scattered like a bad rash round many of our communities.
Mr Davey: We looked at the issue of a Post Bank soon after coming into Government, and we looked at whether we could find money in the spending review to get a Post Bank up and running. But the amount of money to capitalise it was pretty significant, and we had already managed to get £1.34 billion for the spending review to keep the Post Office network running, so that it did not have to have any further closure programme, and to modernise the Post Office network. I think it is fair to say that, given this was a pretty tough spending review to say the least, there was not sufficient money to capitalise a Post Bank.
However, because the concept behind the Post Bank is really very important, I have spoken to Post Office Ltd on a number of occasions, and in our Post Office policy document, which we published in November last year, we talked about trying to get all the high street banks to make their current accounts accessible via the Post Office network. We have got RBS now signed up, so now 80% of current accounts can be accessed over the Post Office network; it is just HSBC and Santander who have yet to join in.
Directly to your point, to repeat the remark I made to Rebecca Harris, I am very keen that credit unions can be accessed over the Post Office network, but that is different from a Post Bank offering those products.
Ann McKechin: Yes, yes,
Mr Davey: It would be the credit unions offering the products via the network. That is the goal, and it sort of mirrors what I was talking about with high street banks. That is the way I think we can ensure these products are more available in an affordable way. But I regret I cannot give the Committee a guarantee we will be able to do that. We are waiting for the DWP report, but certainly in my discussions with ABCUL and POL and DWP, this is a policy area that I have been pushing.

Q245 Chair: Can I just say, we are looking at inviting you back on this issue in the new year?
Mr Davey: I look forward to it.
Chair: It also brings me on to Katy Clark's question.

Q246 Katy Clark: Yes, it is really following on from that. What are you doing to encourage the banks themselves to provide short-term loans but also credit to the socially and financially disadvantaged?
Mr Davey: Our focus with the banks has been on trying to see if we can help people avoid some of the charges they levy, particularly on unauthorised overdrafts, but also to try to improve the information they provide and the transparency they provide to customers with things like the Annual Statement, which will be rolled out for all the main banks by the end of this year. That is not necessarily providing

specific financial products, but it is I hope providing reassurance that they can control their bank accounts more and have better information.

Q247 Katy Clark: Obviously some of that may be, fair play, worthwhile, but in terms of the financially excluded in particular, is that something that you are looking at?
Mr Davey: The past Government did quite a lot on basic bank accounts. There has been some work done by the Treasury. We have had some involvement in it in looking at another type of account that could be used. I am not quite sure where the research is on that, I am sorry. I am sure we could write to the Committee; we do not have a Treasury lead on it, but we could look at that.
We are consulting on improving access to basic bank accounts for undischarged bankrupts. This was something that Citizens Advice raised with me very early on. In many ways undischarged bankrupts were having the worst deal of all, because they could not open any bank account. There were one or two providers, the Co-op Bank, I think, and there was another one, who did allow bankrupts to use bank accounts, but all the other banks said that they would not do it. So our consultation, which is out now, is trying to look to see if you can have remedies, if necessary legislation, to enable undischarged bankrupts to access basic bank accounts.

Q248 Katy Clark: If you are able to write with further information, that would be very useful.
Mr Davey: I am not on the particular Cabinet Committee, the Social Justice Cabinet Committee, that I know is looking at issues in this area, including accessible credit for the disadvantaged. So I will get a report on that, if it is in the public domain, and ensure you have that as well.

Q249 Julie Elliott: We are now moving on to loan sharks. Can you reassure the Committee that the work to prevent illegal loan sharking is continuing in this time of quite severe cuts? How do you ensure that local trading standards do not ignore this work and concentrate on other priorities?
Mr Davey: I would like to start by paying credit to the previous Government. When they set up the pilot of the Illegal Money Lending project in 2004 with a team in Scotland and a team in Birmingham, I think it proved incredibly successful, because in the past Trading Standards, the police and others have not really focused on these loan sharks who were terrorising people in the estates and communities around our country.
The previous Government, in my view, was quite right to expand that project and put more money in it. One thing that I am proud of and pleased that we were able to do in the spending review was maintain funding for the Illegal Money Lending teams. This funding for the project was £5.2 million in 2010–11 and £5.2 million in 2011–12. I see it as a funding priority, because these Illegal Money Lending teams have been so effective. I could give you all the details about how they have been effective, but I do not want to get in the way of your asking questions. But I think they have proved their worth time and time again.

Q250 Julie Elliott: Can you tell us what projects you currently have in operation on illegal loan sharking, and how will you target the illegal loan providers?
Mr Davey: Our main project is through the Illegal Money Lending teams, and our funding through them. They will be doing a whole range of different activities in different communities. In order to try to make sure the money was more effective, we have brought some of the teams together and created three teams: a team each for England, Scotland and Wales, and learnt the best practice. So there are national teams, and then they have community people on the ground, providing advice and support for victims. We have reformed the way Illegal Money Lending teams are operating, but that was on the basis of an independent report, and it was not directed at savings; it was directed at making sure the enforcement was more effective.

Q251 Julie Elliott: How will it be targeting the providers? Giving support to the victims is good and should be happening, but how are you targeting the providers and catching them at what they do?
Mr Davey: I could not give you all the different techniques that the Illegal Money Lending teams operate, but they are arresting and prosecuting people. I can give you some of the outcomes of the project, which go to the end of June this year. The project has identified over 1,700 illegal lenders. It has arrested over 500 illegal money lenders, the loan sharks. It has written off over £37,000,000 of illegal debts; it has secured over 182 prosecutions, resulting in prison sentences totalling over 107 years and one indefinite prison sentence, and it has helped over 16,000 victims of loan sharks, so that will give you an indication that this is a very active programme, and I believe we must continue this work. I think it is incredibly important.

Q252 Ann McKechin: If we could turn to debt management companies, Minister, again this is something that has increased in its level of activity in recent years. Are you concerned about that growth and what impact it has for vulnerable groups?
Mr Davey: I think there is some practice that you hear about that is worrying in the paid-for debt advice sector. There is some evidence that there is some abuse of upfront fees. However, we should not totally dismiss the paid-for sector. They have a role to play. My focus though is on expanding and supporting the free-for-debtor advice services, whether that is Citizens Advice or the Fair Share plans such as Payplan and the Consumer Credit Counselling Service.
That is why we asked the Money Advice Service in July to take responsibility for co-ordinating debt advice across the country. We commissioned them to undertake some research to look at the debt advice landscape, to review it and to work out what our priorities should be. I gave them a bit of steer. I have mentioned this on the floor of the House. I am extremely keen that the free debt advice sector is of the highest quality, is available quickly for people

when they come out from under the duvet, if you like, and are prepared to accept advice, and that it is comprehensive across the country.

Q253 Ann McKechin: Can I just clarify one point? Some commercial debt management companies appear to be lobbying hard to get access to Fair Share funding. Perhaps they worry that upfront fees may be prohibited or restricted in some way in the future. Could you just clarify that, from the Government's point of view, you think that this funding should only be for the charitable or not-for-profit sector?
Mr Davey: I have not been lobbied, but we will look at these issues in the round. I think the priorities I have set out are the ones I am focusing on at the moment. The research that we are hoping to get, probably in the new year, from Money Advice Service will focus on how we use public money as effectively as possible. That might involve channel shifting, it might involve new outreach services, but one of the things I am particularly keen that it does is make sure that the branding of free publicly funded and supported debt advice is strong and well known. As I said in the House last Thursday, the Citizens Advice brand is very strong, very trusted and is something we should build on.

Q254 Ann McKechin: Would you agree that these types of debt advice services that you are talking about should cover everyone? They should not be cherry-picking people just on the basis of their income or their assets in terms of whom they provide advice to, but they should provide advice to everyone.
Mr Davey: Yes. Are you talking about the Citizens Advice type service?

Q255 Ann McKechin: Yes, that type of service.
Mr Davey: Yes, I think the real policy issue is how that advice is delivered, because you have three options fundamentally. You have online, telephone and face-to-face. There is some evidence that some people who may be able to manage their affairs relatively well but have come on hard time—they have lost their job or whatever—actually prefer online or telephone services. If we can encourage a shift to those for those people for whom they are the most appropriate and actually the most preferred services, we can then free up some resources for face to face.
I am sure in your constituency advice surgeries the situation where someone comes to you for advice. They have a plastic bag, they tip it up and it is all the unopened envelopes, and they say, "How can you help me?" The lesson I draw from that is there are an awful lot of people out there really suffering, often depressed or with other mental health problems, and I am not yet convinced that the current debt advice landscape is reaching out sufficiently to those sorts of people. We need to ensure we can free up some money so we can have better outreach services.

Q256 Ann McKechin: I am sure that is something the Committee would support. I have just one final question about the issue of debt management companies and upfront fees. As part of your current review, are you considering the issue about whether upfront fees should be restricted in any way? There is concern about the way in which this operates.
Mr Davey: No, I have seen that. Let us be clear, this is not an unregulated sector. The OFT are the regulators. They did a *Debt management guidance compliance review* in 2009–10. They warned 129 businesses; 53 exited and no longer have licences. Indeed 70 non-compliant debt management services have left the market since September 2010, and they are providing revised OFT guidance on debt management in the new year. I think it is that approach that we need to adopt rather than new regulations. OFT's approach is the best way to drive out the people who are abusing upfront fees.

Q257 Chair: A recent survey—I think it was by A4e—has shown that something like over 60% of people who used with-profit debt management companies ended up feeling that their financial situation had got worse. Do you not think that is a prima facie case for being a lot tougher on them?
Mr Davey: I would say we have a panoply of tools that we are applying here. I have mentioned just now the role of the OFT and their revised, strengthened guidance coming out in the new year. I have mentioned the debt advice landscape review, which I believe needs to develop a system where the free advice sector is stronger and is even better known. We are doing other things in addition. We are in discussion with the industry, with the fee-charging, with the free-to-debtor, with the creditors and with the debt advisers, on new debt management protocols.
The idea is that they will augment the OFT guidance to drive best practice. I believe you can get improvements through the tools I talked about, and by simply going after the upfront fees you may be missing the quickest and best way to improve this sector. Let us remember that the OFT reviewed this sector and did not recommend that upfront fees should go.

Q258 Chair: You mentioned developing the free advice sector. Do you not feel that a measure of the success of MAS and the free advice sector will be a significant diminution of the role of private providers?
Mr Davey: I think that is one potential measure, yes.

Q259 Chair: Would you be looking at assessing in effect the current policy in the light of those measures?
Mr Davey: I think one has to look at what is in the interest of all consumers. What I want to make sure of is that, for those consumers who cannot afford to pay, there is quality free-to-debtor advice available in different forms, and that people know that is available. You have to put yourself, I always think, in the shoes of the debtor. As I said before, often people in debt can be suffering illness, often mental health problems. That is quite typical. Therefore, to assist people who are really very vulnerable, we need to make sure that they know where to go.
I keep talking about the brand awareness of free debt advice services, particularly Citizens Advice. I think that is absolutely critical, and if we can build on the very strong brand that Citizens Advice has to create a

free debt advice sector that is high quality and available across the country—where people do not have to wait very long to be able to access it and that links into the telephone and online services operated by the Fair Share organisations like CCCS and Payplan—I think we can get to a place where I, as Consumer Affairs Minister, can at least feel sure that those people who cannot afford to pay for debt advice know where to get quality free debt advice.

Q260 Chair: Finally, almost by definition, those who need debt advice cannot afford it. Whilst I welcome the approach I think you are talking about in developing the free advice service, if it is fully developed, I would have thought at least in theory nobody would need to go to the with-profit advice service. No logical person voluntarily should pay for something that is adequately provided free, so we come back to the point that, if the service is to be effective, we would really expect a diminution of the role of the with-profit sector.
Mr Davey: I think I have already replied in the affirmative on that. What I am trying to say is, if we can have effective competition from the free-for-debtor advice sector, then the paid-for sector is going to struggle. But let us remember that there are those who are in difficulty who sometimes are still on an income and may prefer to pay for debt advice, because they may think it is going to provide them with a better service in whatever way they decide. So I am not looking to regulate the sector out of existence. I do strongly believe in the OFT, with the powers it has, regulating the sector using its revised guidance. My real aim is to improve the free-for-debtor advice services.

Q261 Paul Blomfield: Just a brief supplementary, Chair. I have to say, Minister, you seem a little bit relaxed about the for-profit debt management sector, when the OFT inquiry actually exposed deep concerns about this sector; 129 out of 172 companies in breach of their guidance.
Mr Davey: Can I say I am not relaxed, if that helps you?

Q262 Paul Blomfield: Well it helps to some degree, because you were creating that impression. But very specifically, you have talked about the OFT's role and its powers. You will recall that in the debate in the House the other week one of the concerns that was raised, I think on both sides of the House, was the long time it takes to revoke licences. Would it not be an appropriate response to give the OFT stronger powers to revoke licences more quickly?
Mr Davey: As I said to, I think, two questions today, when we respond to the consultation on the consumer credit regulatory regime, we will not only be saying who will be carrying out the consumer credit regulatory function but also talking about powers and resources. I do not want to prejudge the response of that consultation. We have not finally agreed it with the Treasury. We have got a bit more to do. But I do want to signal to you that that is the place where I think we will be able to give more of a response to that question.

Q263 Chair: Just moving on, one of the complaints that we receive is the advertising techniques used by these companies, including cold calling and text messaging. Do you think they should be banned?
Mr Davey: I am sorry I keep coming back to the OFT, but that is the regulator. They have issued stronger guidance in that area, not just on cold calling but on warm calling as well. The fact that stronger guidance has been welcomed by a lot of people I hope means that, when they review the market and find people are not complying with that stronger guidance, they will see action taken against them.

Q264 Chair: Sorry, are you saying that, if the OFT find that the current guidance is not adequate to deal with this problem, stronger measures will be taken?
Mr Davey: No, no, sorry. They have strengthened their guidance in this area.

Q265 Chair: Yes, and if it does not work?
Mr Davey: What I was saying was, when they are enforcing and carrying out their regulatory role, they obviously will be looking for businesses to comply with their stronger guidance covering these issues of cold calling and so on. If they find breaches of the guidance, I am sure that they will take enforcement action.
Chair: We will follow this very carefully.

Q266 Paul Blomfield: In helping to develop my understanding for this inquiry, I convened a meeting of debt advisers in my constituency, which was very well attended and a very useful session. Although they recognised the point that you were making about an overdependence on face-to-face advice—and indeed locally their services are looking at ways in which they can reconfigure their offer so that the primary contact is website or telephone advice—they were also at the same time worried that there was a perception in Government and with the Money Advice Service that web and telephone advice could deal with a much wider section of demand than was in fact the case, and that there remains strong demand, or strong need, particularly amongst the most vulnerable, for face-to-face advice. How do you see the future of face-to-face advice when funding ceases at the end of this year?
Mr Davey: Let us be clear. I put a huge value on face-to-face advice. I do not believe there should be any diminution of face-to-face advice. It may well be that those monies are looking at a different group—some people who are missing out on that. You will know, I assume the Money Advice Service told you, that they have secured from the FSA the monies from the levy on the financial services industry for face-to-face debt advice for the next financial year, which is very, very good news. I am glad we have got that for the debt advice community in good time this year.
Ultimately what I am waiting for, which is why I cannot give you a more precise and detailed answer, is some research we commissioned from Money Advice Service in this very space. What we are expecting from that research, amongst other things, is that it will give us an indication of the potential for online and telephone services. I believe there is greater potential

than there is now, and it is not just me. I have spoken to people like, for example, the Consumer Credit Counselling Service, and they believe there is great potential too. They believe that a lot of the people who use their telephone and online services are actually more comfortable with those services, so if there can be some shift and we can free up resources what I want to see is better face-to-face advice, not a diminution but ensuring the quality and accessibility of it. As I said earlier, there will be ideally some outreach services as well, because we know that some of the most vulnerable who are in debt may not actually turn up to debt advice.

We need to reach out, and I can give an example from my constituency of a gentleman who had some mental health problems. Despite a huge amount of work by my office, he was not responding, and he was not responding because the people who were knocking on his door to help him with his debt advice were from the council, because his debt problem was to do with overpayment of housing benefit and they were trying to get some of that overpayment back. But of course, if someone knocks on the door of someone who is quite vulnerable and says, “We are from the council,” they do not necessarily always open the door. I give you that anecdote from my own constituency because it shows how we need to devise and design outreach services. It needs to be very sensitive to the needs of the people who fall into this category.

I am not saying it is a large category, but is one of the neediest categories, and I have just been slightly worried in my own experience, and I do not know whether you have experienced this in your own constituency, that this category of people are not getting the services they need.

Q267 Paul Blomfield: Thank you. Just a brief supplementary. When we are looking at the balance of results of all the different priorities, why are you funding the Money Advice Service to provide a web-based advice facility when those sorts of services already exist?

Mr Davey: Let us see what happens when they give us their research and report about how we take on the debt advice landscape going forward. I agree that we do not want a proliferation of websites and telephone lines and so on to the extent that branding is lost. But equally there may well be a lot of learning that different websites have and different approaches different websites have. I do not want to sit here today and say there should be only one website and one telephone number.

Certainly my experience of a whole range of these different websites is they often have different facilities and different strengths and weaknesses, and may be appropriate for different types of consumers. So I really want to wait and study the research before making any conclusion. I should say just for the record, as it has just come into my mind, we are not funding MAS website-based provision.

Q268 Paul Blomfield: Thank you. One final question from me. It is unrelated, but at this roundtable that I organised with these advisers, they highlighted to me that the biggest reason in their experience for the clients they were dealing with turning to payday lenders was the inability of the benefits system to deliver crisis loans with the speed that was needed. What discussions have you had with colleagues at the DWP on that issue?

Mr Davey: If I am honest with you, Mr Blomfield, it has not been brought to my attention, but I will talk to DWP colleagues as a result of that. I wonder whether it is the only issue though.

Q269 Paul Blomfield: It is not the only issue, but for them it was a significant factor.

Mr Davey: I sometimes hear stories that it can be sometimes difficult to get an immediate appointment for debt advice. One thing that may well come out from the research is the need for a very quick response when someone is—I always say coming out from under the duvet—facing up to the problem and wanting some advice, and when they are there we need to make sure the services are really quick and can help them. I am sure there may be other factors as well, but I put quite some weight on that.

Q270 Chair: Have you assessed what impact legal aid cuts will have?

Mr Davey: I have seen a number of reports of that. We have had adjournment debates in which people have raised that in the House, and Questions in the House. Clearly for particularly some Citizens Advice Bureaux and other advice agencies, it may well have quite a big impact. What we have tried to do, and the Cabinet Office has organised this, particularly with Citizens Advice, is look across Government at the overall impact of the different changes that have been made.

Obviously you have local government, who are a major funder of Citizens Advice, as I am sure you are aware. We ourselves are a big funder of the national Citizens Advice service. We want to make sure, and this is work the Cabinet Office is doing, that there is not a cumulative effect that results in even worse outcomes. So I take the point, and I am afraid these are not easy times. There are cuts being made. What I am keen to do, and one of the reasons why we have now got the levy and the landscape review, is to make sure we are using the scarce resources as efficiently and effectively as possible.

Q271 Chair: Do you think the credit industry could provide more? At the moment it is 3%, I believe.

Mr Davey: Well this levy from this April will get £27 million to fund the face-to-face debt advice service that was previously coming from the taxpayer, so that is quite a significant shift in the direction you seem to be wanting.

Q272 Ann McKechin: There was some discussion in the evidence we took earlier, Minister, about the Scottish system, which has a kind of statutory debt management plan, and a number of the charitable agencies were in support of that. I wondered whether your own Department had considered implementing a statutory debt management plan south of the border, and changing the law.

Mr Davey: We have a statutory plan in the sense that individual voluntary agreements have a statutory basis. But I think what you are referring to is the idea that is in the Tribunals, Courts and Enforcement Act 2007, which will enable us by secondary legislation to bring in a different type of statutory scheme. The last Government consulted on whether they should bring that forward. The response to the consultation sounded one or two alarm bells, in particular that it would not catch everyone, because the way the legislation is written just does not allow people to make a profit. Therefore we exclude a lot of the providers, I think, that you are concerned about.

My understanding is in Scotland they had a similar scheme but then they changed it to get greater coverage. I am not saying that is what we are about to do. We put a lot of store by the IVA. The last Government tried to improve the workings of the IVA with an IVA protocol, which did have some effect in reducing the fees and some of the hurdles that had been put in the way of people accessing an IVA. We have the IVA; it is working better. However, I want to keep all options open as we explore this area, and it is one of the reasons why we have not suggested we take out that option of the 2007 Act, but I have mentioned that it has a few shortcomings.

Q273 Ann McKechin: Okay. Just on this issue about the transition period when Money Advice Service takes over the co-ordination of debt advice across the country, there seemed to be one or two comments you made today around the salary the Chief Executive Officer, the website development and whether or not that is a sensible way forward. Are you confident the Money Advice Service will be in a position to deal with the transition period from 2012? Are you confident that they have sufficient preparation in place to take over what is a task of great responsibility throughout the country at a time when demand for services is clearly increasing?

Mr Davey: I think they have shown in many areas some real understanding. I think they have their business plan, which has now been passed by the FSA—they have secured the budget. I think that will be welcomed across the sector, but we are waiting for the research and their report—I am sorry to keep coming back to that—and I think it is important that is of the highest quality so we can be reassured that the plans going forward are correct and are comprehensive.

Q274 Chair: Finally, Minister, one of the complaints we have had is that internet search engines, such as Google, tend to place with-profit debt management services higher in their list of search results. Will you be taking action to ensure, as part of parcel of enhancing the capability of the free debt management service, that Google change this?

Mr Davey: It is something that I have raised as well, because it does strike me that this can create some real problems. I would hope that the search engines would exercise some corporate social responsibility in this area. We did have the OFT looking at this over the summer, and they published some guidance on it. I think I quoted from it in my response to the debate last Thursday, on 1 December, and I talked about the fact that the OFT had looked not just at Google but all social media—Twitter, Facebook and so on.

They revised their guidance after the consultation, so it now states, "Licensees who advertise or sell online or by email must comply with the Electronic Commerce Directive, and before using internet-based and social media marketing, licensees should consider whether they can exercise adequate control over its content. The OFT considers that search engine sponsored links and online messaging forums which limit the number of characters are unlikely to be an appropriate means of providing balanced and adequate information." As I said at the time, that is slightly technocratic language to say that, if they rely on that sort of marketing and it is not giving the consumer the full information, they may well take enforcement action.

Q275 Chair: If I can just decipher that, you are looking at taking enforcement action if this continues?

Mr Davey: Well, OFT, I think.

Chair: OFT, yes.

Mr Davey: And I should also add, because I think it is an important point, that Citizens Advice are now working with Google on this issue. The protocols that we are looking at may also be able to cover this area to get agreement on what is appropriate for advertising in social media.

Q276 Chair: I suppose the logic is, if the OFT in, if you like, exercising its influence on that still fails to prevent this happening, will you look at it again?

Mr Davey: It is an area we will keep under review. I have raised it myself as a concern. But as I say, we have a number of actions already, and it was only this summer that the OFT consulted on it and has only just revised its guidance, so I think we ought to give that a little bit of time to work.

Chair: Thank you, Minister. That was very helpful. We will be assessing the evidence and making recommendations in due course. Thank you very much.

Written evidence

Written evidence submitted by the Department for Business, Innovation and Skills

Further to the Committee's recent announcement of their inquiry into debt management, please find enclosed the Government's final response to its Review of Consumer Credit and Personal Insolvency. Our final response and our interim response published in July, which I also enclose, form the Government's formal written evidence to the Committee's investigation.

The Government is committed to curbing unsustainable lending and strengthening consumer protections, particularly for the most vulnerable. We launched the Consumer Credit and Personal Insolvency Review last year to gather evidence on how to deliver these commitments. The Government's vision is twofold. First, we want all consumers to be empowered to make better choices for themselves. Consumers should be free to borrow if that is what they decide is in their best interest, but in line with the Coalition principles of freedom, fairness and responsibility, we want to provide consumers with the tools they need to make informed decisions. Second, we want to ensure there is a safe and fair regulatory framework for both credit and personal insolvency.

Our July response announced the Government's proposals on the Personal Insolvency aspects of the Review. The measures announced in this publication will begin to address the two main concerns identified by the Review, recognising the importance of free and independent debt advice; and concerns regarding the debt management industry.

The Government's final response contains the full response on the Consumer Credit parts of the Review, including our proposals on the three Coalition Commitments and actions to improve consumer protections in the high cost credit market.

I am confident that the package of measures announced in the two documents, alongside other significant developments in the consumer credit market and personal insolvency framework, including new consumer protections introduced as part of the Consumer Credit Directive and our proposals to reform bankruptcy applications, will deliver real benefits for consumers that can be achieved while minimising the regulatory burdens on business.

I understand that the Committee have had the opportunity to have an informal briefing from the Officials in my Department on these issues and I hope that you and Members of the Committee found this helpful. I am grateful to the Committee for allowing the Government an extension to submit this evidence.

I am copying this letter to the Financial Secretary to the Treasury.

Edward Davey MP
Minister for Employment Relations, Consumer and Postal Affairs

21 November 2011

Further written evidence submitted by the Department for Business, Innovation and Skills

Further to the informal briefing for Members of the Select Committee on the 8 November, I agreed to write with the additional information requested by the Committee.

The Committee asked for information on household debt levels. Below are the latest figures available to BIS on the level and composition of household debt.

Household Debt[1]

— Total household debt in September 2011—£1.45 trillion.
— Total secured debt (mortgages etc) in September 2011—£1. 24 trillion (85%).
— Total unsecured debt (credit cards etc) in September 2011—£209 billion (15%).

Breakdown of Unsecured Consumer Debt[2]

— Personal loans–around £130 billion.
— Credit cards—around £55 billion.
— Overdrafts—around £10 billion.
— Retail finance including store cards—around £10 billion.
— High cost credit—2% around £7-£8 billion.

Other Stats[3]

— Average household debt in the UK is ~ £55,795 (including mortgages).

[1] Credit Action—National Money Education Charity.
[2] YouGov Debt Tracker Survey.
[3] Credit Action.

— Average owed by every UK adult is ~ £29,532 (including mortgages).

— Average consumer borrowing via credit cards, motor and retail finance deals, overdrafts and unsecured personal loans has risen to £4,247 per average UK adult at the end of September 2011.

— The Office for Budget Responsibility (OBR) predicts that household debt will be £2.13 trillion by the end of 2015. This would take the average household debt to £81,769 per household (if the figure is based on the current estimate for the number of UK households.

In addition the Committee asked for a breakdown of the use of high cost credit type products:[4]

— Home collected credit—£4 billion typical APR 3–400%.

— Payday loans—£1–2 billion (Approx) typical APR 2500%.

— Pawnbroking—£1–2 billion (Approx) typical APR 100%.

— Bills of sale lending (Logbook loans)—£30–£40 million typical APR 4–500%.

BIS does not hold figures on the number of payday loans applied for each year, but research for Consumer Focus in 2009[5] estimated that there were 4.1 million successful applications for payday loans resulting in total lending of £1.2 billion.

On the levels of illegal lending in the economy, there is no data to suggest that this is increasing.

The Committee also asked for information relating to Personal Insolvency and Debt Management. Please see the attached annex, which sets out profiling information about debt relief orders (DROs), bankruptcies and individual voluntary arrangements (IVAs) that we have available.

In addition, the Committee asked for information about the level of assets and liabilities in each formal procedure. With regard to DROs, the entry criteria are set so that a person is only eligible for a DRO if (a) their debts do not exceed £15,000, (b) their assets do not exceed £300 in value (certain assets do not count, for example clothing, furniture and a vehicle worth less than £1,000), and (c) their surplus income does not exceed £50 a month after paying essential personal and household spending. With regard to both bankruptcies and IVAs, the range of both assets and debts will vary and are not recorded centrally. However, in individual cases the creditors will be aware of the situation from reports submitted by the Trustee in bankruptcy (who could be the official receiver based within the Insolvency Service, or an insolvency practitioner appointed to act as trustee by the creditors) and the Supervisor in an IVA.

I hope that the Committee will find this additional information useful.

Annex

1. Personal insolvency profile

1.1 *Debt Relief Orders (DROs)*

In 2009 women accounted for 63% of DROs. The 25–34 age group contained the highest proportion of DROs (25%), as shown in Table 3 below. The over 65 age groups accounted for the lowest proportion of DROs (6%).

Table 3

DROs BY AGE GROUP, 2009

	Total	*Proportion of bankrupts*
Under 25	1,406	12%
25–34	2,941	25%
35–44	2,730	23%
45–54	2,451	21%
55–64	1,571	13%
65+	708	6%

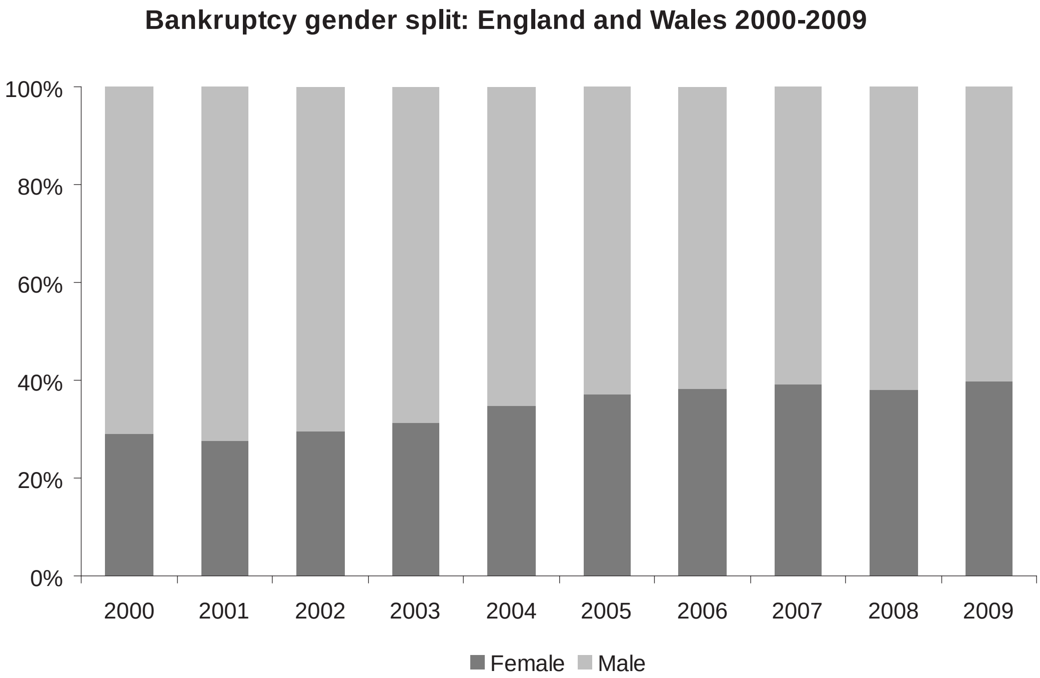
1.2 *Bankruptcy*

In 2009, as shown in Figure 1 below, women accounted for 40% of bankruptcies. This proportion has increased generally from 29% in 2000.

4 http://www.oft.gov.uk/shared_oft/reports/consumer_credit/High-cost-credit-review/OFT1232.pdf
5 http://www.consumerfocus.org.uk/assets/1/files/2010/02/Keeping-the-plates-spinning.PDF

Figure 1

BANKRUPTCY AND GENDER



In 2009 the 35–44 age group contained the highest proportion of bankruptcies (33%), as shown in Table 1 below. The under 25 and over 65 age groups contained the lowest proportion of bankrupts (both 4%).

Table 1

BANKRUPTCIES BY AGE GROUP, 2009

	Total	*Proportion of bankrupts*
Under 25	2,735	4%
25–34	18,407	25%
35–44	24,167	33%
45–54	16,993	23%
55–64	8,208	11%
65+	2,810	4%
Unknown	988	

As shown below in Figure 2, the proportion of bankruptcies accounted for by sole-traders generally declined from 44% at the start of 2001, to 12% in Q3 2010. In recent quarters, however, the proportion has picked-up, to 20% in Q2 2011.

Figure 2

SOLE TRADER BANKRUPTCIES

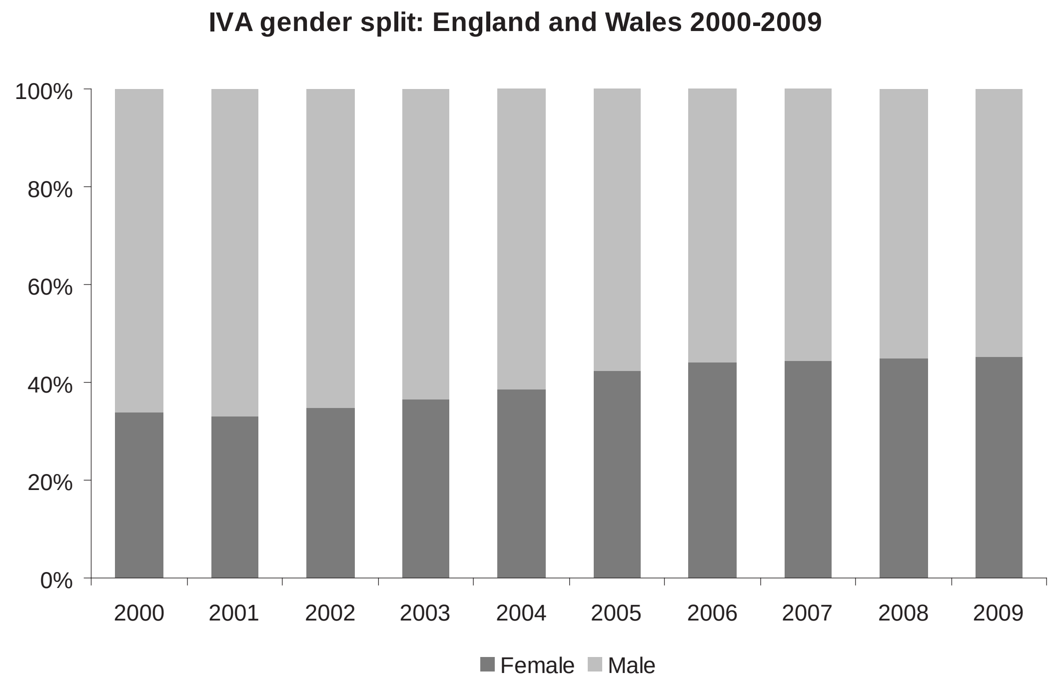
NB: sole-trader bankrupts may also have liabilities that are unrelated to their business.

1.3 *Individual Voluntary Arrangements (IVAs)*

In 2009, as shown in Figure 3, women accounted for 45% of IVAs. This proportion has increased generally from 34% in 2000.

Figure 3

IVAs AND GENDER



In 2009 the 35–44 age group contained the highest proportion of IVAs (35%), as shown in Table 2 below. The under 25 and over 65 age groups accounted for the lowest proportion of IVAs (both 3%).

Table 2

IVAs BY AGE GROUP, 2009

	Total	*Proportion of IVAs*
Under 25	1,553	3%
25–34	12,642	27%
35–44	16,222	35%
45–54	10,426	23%
55–64	3,974	9%
65+	1,188	3%
Unknown	1,553	

Kirstin Green
Deputy Director, Consumer Empowerment

22 November 2011

Written evidence submitted by A4e

As providers of a wide range of front-line public services to the socially and financially excluded, A4e has rich experience of the multiple challenges people face in staying afloat. Within the broad range of social welfare issues which occur across our customer base, we witness disproportionately high levels of personal debt; limited access to affordable financial products; joblessness; poor skills; poor health (both mental and physical), and a need for consumer protection.

Since demand for consumer credit loans is largely counter-cyclical, the current economic climate makes it all the more important that the Select Committee is seeking to draw attention to this issue. Often very vocal representations are made on behalf of the credit industry itself, yet they have little experience of the problem from a social justice perspective, and no reason to approach the issue in terms of the well-being of financially vulnerable individuals. The safeguards which many respondents on consumer credit and insolvency[6] have flagged up (such as the five new rights for credit card customers) are often irrelevant for our customer cohorts, because so many of them are unbanked, and excluded from mainstream financial products. These are the customers who pay a poverty premium on pay-day loans and other expensive forms of credit.

Our customers are more likely to need credit, yet less likely to gain access to it. If they do manage, they are more likely to fall prey to unscrupulous practices, and that in turn is likely to affect them disproportionately. If they are unfairly dealt with, because of their financial capabilities, they have less chance of redress. For this reason, we think it important to speak on this issue from the perspective of our customers.

There is a clear social justice case for tackling the UK's high levels of personal indebtedness. Yet tackling debt is also an issue that is integral to the growth agenda. High levels of debt are stifling consumption, and depressing Britain's local economies. These reasons make it imperative to act now.

Growth

Debt is not a bad thing per se, and easy credit can have an expansionary effect on the economy. However when levels of debt get too high, it has the opposite impact. In the immediate term, a one-off measure to reschedule the worst of consumer debt—the debt that is anyway unlikely to be repaid—could act as a quick and easy stimulus to the growth of local economies. Growth measures tend to be supply-side; centring around the provision of skills or infrastructure. As such their effect can take many years to be felt. If the Government were to reschedule the problem debt of the very poorest, it could act as a progressive way of putting pounds back into consumer's pockets, fast.

The case for action is this: Places with high levels of personal debt map accurately onto the UK's most sluggish local economies. People put all their income into servicing their loans, and consumer confidence remains depressed. In any case, because consumer debt is not a "priority" debt, lenders frequently register losses on the people targeted by the measure we propose. Therefore as well as helping the individuals concerned, this measure aims not to damage, but to increase the chances of lenders recovering their money from those who have taken out high interest loans in times of crisis. If the Government were to take advantage of historically low bond rates and purchase "problem debt" from high street lenders at a reasonable margin of perhaps two-figure interest, then consumers would have a greater chance of repaying those debts in full than they do at punitive four-figure interest rates. Creditors would get an immediate buyout that is higher than the initial cost of the loan, with a small portion of the rescheduled payment going to the Treasury to cover the cost of transaction. This sort of stimulus would be highly targeted geographically, and extremely progressive. Although

[6] http://www.bis.gov.uk/assets/biscore/consumer-issues/docs/c/11–1063-consumer-credit-and-personal-insolvency-responses

the government temporarily assumes the role of creditor, it would provide the government with savings in the medium and long terms as those people spiralling into debt avoid incurring further problems and reliance on the state for their welfare. It would be a measure for social justice and for growth at the same time.

Debt sits in a Matrix of different Problems

Our experience shows that financial difficulties almost always sit embedded in a network of other problems. The role that the Work Programme can play in tackling these issues holistically is a great positive—it being the case that the alternative of disparate services and disparate points of access create a confusing customer experience, and militate against the chances of resolving the problem.

Because of the causal relationship between different welfare issues, early identification and early intervention are key to solving debt-related difficulties efficiently and at root. To illustrate the process of escalation that can ensue following a relatively minor setback, the diagram below reflects the real life experience of one of A4e's Flexible New Deal customers.

Case study: A4e customer experience

If different welfare problems for which different advice services currently exist in isolation can be shown to spring from the common origin, then early intervention is key. Otherwise we risk simply dealing with the disparate manifestations of debt troubles. Indeed we have found that focussing on the immediate symptoms can create a dependency culture—50% of customers in our Community Legal Advice Centres are repeat customers, because the constraints of the silos in which government-sponsored provision operates mean that such advice is not necessarily linked up with changing the behaviours that precipitate the need for advice in the first place.

An easy means by which to ensure prevention rather than cure is to make financial advice available, and consumer rights known, at an early stage. As a nation we spend millions providing financial advice each year. This provision is fragmented. A way to make sure that the funding that exists meets its mark most efficiently is to offer it to people who are at the point of loan, advertised at the expense of the creditor. Currently there exist strong incentives to purchase financial products at the point of sale, however consumers need sober disincentives as well. Better publicity of debt advice would also address the fact that only one in six people for whom debt payments are forming a "heavy burden" are accessing the advice they need.

The Open Society Agenda

A4e has conducted a series of focus groups with our customers in order to gauge their opinions on the Open Public Services agenda, and found that they overwhelmingly support the idea of diverse provision, caring most about the quality of service and not the identity of provider. As healthy as such a diverse public services ecosystem can be, the fragmentation of advice services run by different bodies can create a confusing experience for those accessing debt advice. In the interests of a more seamless experience for the customer, it should be possible to direct people through a single interface, behind which sits a diversity of providers and channels of advice. If the initial sign-posting work was done largely face-to-face, with subsequent case-work done over the phone, savings could be made at the same time as improving access to provision for disadvantaged customers.

A Predatory Market

Unfortunately, financial education can only go so far. The Barrow Cadbury Trust has show that currently only 10% of debt comes from profligacy[7]. Now more than ever the need for credit and the surge in payday loans reflect the fact that people are finding it hard to pay their basic household bills. The dramatic rise of Wonga is just one of the signs that this problem is out of hand. Voluntary regulation is evidently not working, with the market getting more powerful at the expense of the poorest consumers who pay a premium to access the credit that their better-off counterparts can get for cheap. If the Select Committee is not minded to recommend further regulation or capping interest rates at the most pernicious end of the consumer credit market, then recommendations should take positive steps towards creating a more level playing field for Credit Unions and ethical lenders.

12 December 2011

Written evidence submitted by the All Party Parliamentary Group on Debt and Personal Finance

Key Points

- Too often fee charging debt management companies make people's debt problems worse not better.
- There is an urgent need for better regulation of the fee charging debt management sector including an immediate ban on cold calling, charging upfront fees before an agreement has been reached with the client's creditors.
- The regulator needs better powers to move quickly to suspend trading pending investigation of those companies engaged in activity causing widespread consumer detriment and impose significant fines.
- 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 about the most appropriate debt remedies for them, free from commercial pressure and regardless of their disposable income.
- There is a need for the government to reconsider introducing the statutory debt management plan provisions in the Tribunal, Courts and Enforcement Act 2007, or consider introducing measures with a similar purpose. People in debt who engage constructively with their creditors, seek advice and pay what they can objectively afford should be protected against further collection or enforcement action and spiralling debts.

About the All Party Parliamentary Group on Debt and Personal Finance

The All Party Parliamentary Group on Debt and Personal Finance was established in 2003 to provide a forum for MPs and peers to discuss debt and personal finance issues, to monitor legislative developments in this area, and to provide an opportunity for liaison between Members and organisations with an interest in these issues.

The Group is chaired by Yvonne Fovargue MP and the other officers include: Nicholas Dakin MP, Mike Weir MP, Andrew George MP, and Damian Hinds MP.

Several members of the group including the officers are campaigning for more effective regulation of high cost credit and the fee charging debt management sector, as well as the need to ensure that people in debt can access high quality free debt advice by maintaining capacity in the not for profit sector.

The secretariat for the Group is provided by the Citizens Advice Public Affairs team, and funding for the Group's activities is provided by the subscriptions levied on affiliate members.

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[7] p36 "*A Nation Living On The Never-Never: Policy Solutions to Reduce Britain's Personal Debt Mountain*" ed Mick McAteer. The Smith Institute.

Debt Management Plans and Debt Management Companies

A debt management plan is an arrangement with creditors to pay back a debt by regular instalments. Some organisations (such as Citizens Advice Bureaux) will negotiate a repayment plan with all a client's creditors on their behalf, while the client retains responsibility for administering the monthly repayments to each of their creditors.

Debt management companies (DMCs) collect a single monthly payment from the client and administer the repayments to each of their non-priority creditors (ie consumer credit debts) on their behalf. Usually the client will have to pay for this service although there are some DMCs who will do this for free, such as the Consumer Credit Counselling Service (CCCS) and Payplan. These DMCs are funded through a fair share approach to debt management. This ensures that the creditor, rather than the debtor, pays for debt advice and support by returning a percentage of the payment made by the debtor to the debt management plan operator. The creditor, however, credits the debtor with the amount of the full payment.

The APPG on Debt and Personal Finance is concerned that the experiences of members' constituents and Citizens Advice Bureaux clients across England and Wales highlight consumer detriment arising from the practices of some DMP providers. This includes providing poor advice, poor service and excessive charging as well as cold calling and charging upfront fees for services which do not materialise. Bad practice by debt management companies can make debt problems much worse and harder to get out of.

It is our view that all too often fee-charging debt management companies do not provide anything like an adequate service to people in unmanageable debt.

Over 70 MPs have signed EDM 1948 which calls on the Government to take urgent steps to introduce more effective regulation of the fee-charging debt management sector, including an immediate ban on cold calling, an immediate ban on the charging of upfront fees for debt management services from clients before an agreement has been reached with the client's creditors and the client has received confirmation regarding what this agreement entails, and effective auditing of for:

Bad Practice by Debt Management Companies

Citizens Advice Bureaux frequently report concerns about the practices and service provided by fee-charging debt management companies. During 2009–10, Citizens Advice Bureaux in England and Wales dealt with 3,000 enquiries about debt management services, a 16% increase on the previous year.

Issues reported include:

Cold calling and aggressive marketing practices—where often the client has not given permission for their details to be released to the company

For example

A CAB in Damian Hinds MP's constituency saw a couple who had entered in to a debt management plan following a cold-call from a fee charging debt management company. At the time the couple had been close to panic about their debts, which totaled almost £70,000. In addition, the wife, who took the call, was disabled and was recovering from a brain haemorrhage. As a result, the couple were repaying £109 per month to their creditors but paying the debt management company £209 per month in fees. The couple had mentioned to the company that they would like to seek advice from a Citizens Advice Bureau, but the company advised them not to.

Another CAB in Damian Hinds MP's constituency saw a man who had county court judgments. After judgment had been entered, he received a letter from a fee-charging debt management company offering debt management services. The client initially believed that the letter was from the court because all of his county court judgment details were listed at the top of the letter. The letter did not state that the company would make a charge if the client took out a debt management plan with them. He showed the letter to the bureau who advised him not to follow up contact with the company.

Excessive charges for debt management services

For example

A CAB in Yvonne Fovargue MP's constituency saw a client who had a debt management plan with a fee-charging company. They were repaying £100 per month through the debt management plan but the company was taking £35 of this each month in administration charges.

Charging up front fees for services which fail to materialize or without making it clear to the client what they can expect in return for the payment

For example

A CAB in the East of England saw a self employed builder who had been unemployed for 18 months due to mental health problems but was now looking for work. His wife worked part time. Two and a half years earlier, the couple had bought a car on a hire purchase agreement. They were managing the repayments until last October when they were no longer able to maintain them due to the work situation. Out of the blue, the client's wife received a phone call from a debt management company asking if they had any debts. She told them about the hire purchase agreement and subsequently agreed to pay the company £135 per month: £30 as a management fee and £105 towards repaying the hire purchase agreement. The client subsequently received a default notice from the hire purchase company. The client did not know why he had received it as he was up to date with his payments to the debt management company.

Poor advice, particularly where other debt remedies would be more suitable for the client's circumstances

For example

A CAB in Wales saw a client who had received inappropriate advice from a DMC. The client was on a low income and had multiple non-priority debts together with a small amount of rent arrears. He had entered into a DMP, which he initially wrongly believed was an individual voluntary arrangement (IVA). The bureau identified that in fact, a debt relief order would have been most suitable for the client's circumstances and advised him so. After that, the client was contacted by his DMC which suggested he might qualify for an IVA. However, this was not appropriate as the client had less than £200 per month surplus income and no assets. The DMC's assessment of the client's income and expenditure would leave him with only £60 per month for all housekeeping.

Failure to pass on payments to creditors

For example

A CAB in London reported that a 75-year-old pensioner had taken out three unsecured loans to do work on her house. The contractual payments for these loans came to approximately half of her total income. The client was unable to maintain the minimum payments and engaged a DMC to negotiate and make reduced payments on her behalf. However, unknown to her, the company was experiencing financial difficulties and did not pass on most of the payments that the client made. The company had subsequently ceased trading and the management of the client's debts had been taken over by another company. However, the debts had been sold to a debt collector and the client was facing court action and potentially a charging order.

Ignoring priority debts, such as mortgage/rent, fuel and council tax, where the ultimate sanction for non-payment is loss of home, fuel supply or liberty

For example

A man went to see a CAB in the South West because he was being threatened with eviction. He had set up a DMP with a fee charging company and was using his disposable income to pay off his non-priority debts. As a result he was not paying his rent and was therefore at risk of becoming homeless.

Excessive charges for debt management services

For example

A CAB in the East of England saw a man with two credit card debts totalling £15,000. He had previously contacted a debt management agency who had arranged a repayment plan of £61.43 per month. However, £29 of this amount was their fee, meaning that only £32.34 went towards the debt. The CAB calculated that it would take the client almost nine years to clear this debt at this rate, during which time the debt management company would receive £13,450 for doing very little.

Action by the Office of Fair Trading (OFT)

All providers of debt management and debt advice services have to have a consumer credit licence from the OFT. The OFT sets out the behaviour it expects from licence holders in general and subject specific guidance. There has been detailed guidance on debt management practices since 2001.

In September 2010, the OFT published the findings of its review into industry compliance with their debt management guidance. The findings of this review support the APPG's and Citizens Advice's 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.

In October 2011 the OFT updated its debt collection guidance setting out what the OFT expects of all those engaged in the pursuance of consumer credit related debts.

Limitations of Debt Management Plans as an Effective Remedy for Multiple Debt

Even where debt management companies operate in accordance with best practice, as a form of voluntary agreement DMP's cannot offer a firm guarantee of protection from creditors' collection and enforcement activity. Neither can they guarantee that a client' offer will be accepted and that creditors will not continue to add interest and charges. Many debt management plans fail because some creditors are unwilling to accept reduced offers of repayment. For example

> A CAB in the South West of England saw a lone parent on benefits who owed about £15,000. She had been paying £100 per month to a debt management company for two years; however, her debts were still increasing as interest was being added to her loan at a greater rate than the repayment. The client told the CAB that she could no longer continue with payments to the debt management company.

The APPG on Debt and Personal Finance believes that people in financial difficulties who contact their creditors, seek advice and pay what they can objectively afford should be protected against further collection or enforcement action and spiralling debts. However at present people who try to take responsibility for their debts can find themselves at the mercy of unhelpful, aggressive and unscrupulous practices that can make dealing with debt an unbearable experience. Many people become vulnerable to sharp practices by unscrupulous debt management companies because of they are under intense pressure from their creditors.

At present insolvency options are the only available options for people seeking guaranteed protection from their creditors, but these are not always appropriate. Homeowners who suffer a temporary or severe income shock, such as losing their job, may not want to pursue insolvency as it means they would lose the equity in their home. People on very low incomes may be unable to afford a bankruptcy application or the monthly repayments required under an IVA.

A statutory debt management plan could remedy this, giving a guarantee of fair protection to people trying to deal with their debts in a responsible way by repaying what they can afford. We are disappointed that the Ministry of Justice have decided not to implement the statutory debt management scheme contained in the Tribunals Courts and Enforcement Act 2007.

Most debt management plan providers require clients to make a minimum repayment each month so they are unsuitable for clients with very low disposable incomes. There will always be a need for a free independent debt advice service for those on the lowest incomes who are unattractive to commercial debt remedy providers. In 2008 58 per cent of CAB debt clients were unable to make any offer of repayment to their non-priority creditors after meeting their essential expenditure.[8]

Recommendations for More Effective Regulation

The APPG on Debt and Personal Finance recognises the Government's commitment to supporting businesses and introducing new regulation only as a last resort. However, members of the group from both sides of the house agree that robust action is needed to protect vulnerable consumers from bad practice on the part of fee-charging debt management companies.

As well as sustainable investment in the not-for profit advice sector, there is an urgent need for more effective regulation of the fee-charging debt management sector including

— an immediate ban on cold calling

— an immediate ban on the charging of upfront fees for debt management

— effective auditing of for-profit debt management companies

Cold Calling and Upfront Fees

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) and to prohibit lenders, brokers and debt management firms from taking any upfront payment in respect of 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 the clients creditors and what that

[8] *A life in debt The profile of CAB debt clients in 2008*, Citizens Advice, February 2009.

agreement entails, including whether or not the creditors have agreed to freeze interest and charges. If debt management companies cannot charge large upfront fees, but are forced instead to recoup their costs over the course of the debt management plan, this removes the incentive for companies to mis-sell inappropriate debt management plans or charge unsustainably high monthly repayments.

We also believe that there is a need for the OFT and the Information Commissioner's Office to work together to investigate the way that consumer contact information is being used by credit firms. We are particularly concerned at evidence suggesting that information passed among firms is being used for predatory targeting of consumers in financial difficulty.

Better Powers for the Regulator

The OFT recently revised their Debt Management Guidance to explicitly reference unfair practices connected to cold calling and make it clear to firms that these will not be tolerated in future. Although the OFT has issued guidance on debt management, the OFT does not have the powers and resources needed to supervise the smaller to medium sized practitioners effectively.

Although the OFT now has more extensive regulatory powers as a result of the Consumer Credit Act 2006, we are concerned that enforcement action has, historically, been slow and there is a need for quicker and more nimble enforcement mechanisms. Proving that a firm has engaged in "unfair practice" can be a lengthy and resource intensive process. In our view the OFT needs powers to suspend trading pending investigation and set more prescriptive, positive standards for firms to meet. They should also have the power to impose larger fines which act as a real deterrent to businesses engaged in sharp practices.

Should responsibility for consumer credit regulation pass to the proposed new financial services regulator, the Financial Conduct Authority, we believe that it will need to have sufficient powers and resources to take effective action against debt management firms.

The Need for a Statutory Scheme

There is a desperate need for the government to reconsider introducing the statutory debt management plan provisions in the Tribunal, Courts and Enforcement Act 2007, or consider introducing measures with a similar purpose. People in debt who engage constructively with their creditors, seek advice and pay what they can objectively afford should be protected against further collection or enforcement action and spiralling debts. The absence of such protection makes people in debt vulnerable to sharp practices by unscrupulous debt management companies.

Funding for Free Debt Advice

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 about the most appropriate debt remedies for them, free from commercial pressure and regardless of their disposable income. Over half of CAB debt clients have no disposable income with which to repay non-priority debts (ie debts for which one cannot lose one's home, liberty, or supply of essential goods and services) and so will never be attractive to commercial debt management providers. In Spring 2011 several members of the APPG on Debt and Personal Finance raised the issue of future funding for free debt advice with the Government asking Parliamentary Questions, signing EDMs and participating in Westminster Hall debates on the issue. We warmly welcomed the Government's response that the Financial Inclusion Fund would continue for another year, providing £27 million for face to face debt advice. However, free debt advice agencies need certainty beyond the end of this financial year. We believe that there should be a levy on the financial services industry to supplement central and local government funding for free debt advice.

14 November 2011

Written evidence submitted by the Association of British Credit Unions Limited (ABCUL)

1. Summary

- We welcome the opportunity to respond to this consultation on behalf of our 275 credit union members in England, Scotland and Wales.
- Credit unions provide safe savings, affordable credit and other financial services to over 900,000 people in Great Britain.
- Credit unions are the only lenders in Britain which are subject to an interest rate cap—limited to lending at no more than 2% a month on the reducing balance, which equates to an APR of 26.8%. Many loans are made at less than this rate.
- We responded to the Government's 2010 review of Consumer Credit and Debt and called for actions to be taken to help support credit unions to sustainably and responsibly extend affordable credit to its members and help steer consumers away from high cost credit options. The main suggestions were:

— Consideration of a "wealth warning" on advertising for high cost loan products, ideally directing people towards sources of information about lower cost credit, including credit unions.

— Scrutiny of the pricing practices of rent-to-buy retailers, where the stated APR is misleading as extra costs including insurance and high starting costs inflate the cost to a high cost level.

— Consideration should be given to the fact that APR is a poor indication of interest charges on short-term, small-sum credit and that a total cost of credit charge—in monetary terms per £100 borrowed would be a better indicator.

— Improve the credit history data that is available through credit referencing agencies such as including debts to all high cost credit, rent-to-buy purchases, social housing rent arrears, tax arrears and utilities arrears.

— Increasing the capacity of social lenders.

— Penalty charging for current account services needs to be reformed and made more transparent.

— Full recognition is required for credit unions and other ethical lenders in the debt and insolvency system.

2. Introduction

2.1 We welcome the opportunity to respond to this consultation. ABCUL is the main trade association for credit unions in England, Scotland and Wales, and our members serve around 80% of Britain's credit union membership. Credit unions are not-for-profit, financial co-operatives owned and controlled by their members providing safe savings and affordable loan facilities. Increasingly a small number of credit unions offer more sophisticated products such as current accounts, ISAs, Child Trust Funds and mortgages.

2.2 At the end of June 2011, credit unions in Great Britain were providing financial services to 826,557 adult members and held more than £689 million in deposits with more than £561 million out on loan to members. An additional 114,000 young people were saving with credit unions.[9]

2.3 At 30 September 2010, the 325 credit unions belonging to ABCUL were managing around £512 million of members' savings on behalf of over 611,037 adult members.

2.4 The Credit Unions Act 1979 sets down in statute the objects of a credit union; these are four-fold:

— the promotion of thrift among members;

— the creation of sources of credit for the benefit of members at a fair and reasonable rate of interest;

— the use and control of their members' savings for their mutual benefit; and

— the training and education of members' in the wise use of money and in the management of their financial affairs.

2.5 Credit unions in Britain are small, co-operative financial institutions often extending financial services to those unfairly excluded from the financial services the majority take for granted. They are owned and controlled by a restricted membership and are operated for the sole benefit of this membership. The Credit Union Act 1979 sets down these operating principles in law.

2.6 In the past decade, British credit unions have trebled their membership and assets have expanded four-fold. As this growth has taken place, the role that credit unions can play—both in providing equitable financial services to the whole of their communities and providing diversity in the financial services sector—has been increasingly recognised by government and policy-makers.

2.7 The Coalition's Programme for Government committed to promoting mutuals as part of a diverse financial services system and the Department for Work & Pensions is currently conducting a feasibility study the outcome of which will determine whether and how the earmarked £73 million credit union modernisation and expansion fund will be invested in the credit union sector.

2.8 A Legislative Reform Order has recently been made which will make changes to the Credit Unions Act 1979 and free up credit unions to reach out to more people.

2.9 Both of these initiatives demonstrate the strength of the Government's commitment to the promotion of credit union growth in Britain and a cornerstone of any growth strategy is the implementation of effective, appropriate and proportionate regulation.

3. ABCUL's Response to the Government Review of Credit and Debt

3.1 We have concerns about the structure of the credit and debt system and the effect that it is having both on vulnerable consumers and on credit unions' ability to serve them. We made these concerns clear and set out possible remedies in our response to the Government's debt and credit review last year.

3.2 We set out our proposed action from Government and the rationale behind this below:

[9] Figures from unaudited quarterly returns provided to the Financial Services Authority

3.3 *Scrutiny of the "coloured-pricing" practices of rent-to-buy retailers such as Brighthouse where prices are inflated to reduce the stated APR*

Rent-to-buy retailers are a major growth industry. Many recent news reports have demonstrated the remarkable growth of the sector over the past year or two. Such retailers are able to advertise reasonable-sounding APRs of around 30% but supplement this through requiring their customers to take out insurance cover for goods purchased. This can see goods cost significantly more than they would elsewhere—often more than double the cost from other providers.

3.4 *The importance of providing better information on the availability of affordable credit—for example, an obligation for high cost lenders to flag up credit unions at the point of sale*

Often people who use high cost lenders are in need of quick cash for an emergency expense. They are not rationally "shopping around" but obtaining cash any way they can. Also, the marketing techniques of these firms—door-to-door, aspirational or "quick fix" TV advertising—can encourage consumers to take up offers of credit without comparing the long term costs, only whether they are affordable on a weekly or monthly basis. Because of this it is vital that alternative, more affordable credit sources are made known to them and, therefore, a requirement to flag up credit union loans at the point of sale could reduce people's reliance on high cost alternatives. Baroness Wilcox, BIS Parliamentary Secretary in the House of Lords, recently expressed interest in this proposal in response to an oral question from Lord Kennedy of Southwark.

3.5 *Price comparison for high-cost credit under the www.lenderscompared.co.uk service as set up as part of the recommendations of the Competition Commission's review of the home credit market should take account of the fact that many of the target market do not have access to the internet*

Whilst the internet has become ubiquitous in the modern world, it is generally those that are most vulnerable and on lower incomes that lack access. Disclosures about other credit available should be obligatory for these lenders at the point of sale.

3.6 *Consideration should be given to the fact that APR is a poor indication of interest charges on short-term, small-sum credit and that a total cost of credit charge—in monetary terms per £100 borrowed—should be a requirement of credit advertising standards*

APR—annualised percentage rate—is, as the name suggests, a means of calculating the annual interest charge for credit. Because of this specific, annual nature, small sum, short term credit over a period of only a few months or weeks can provide APRs of hundreds or thousands of percent. We would prefer a more intelligible measure based on the total cost of a loan per £100 borrowed. This would serve much better in demonstrating in an easily understandable way the cost of different short-term borrowings which translates easily into comparison between lending and is directly relatable to a person's budget. Obviously, given that APR as a measure is bound by EU legislation this would likely need to be a complementary measure alongside the APR but would enhance the level of information available to consumers when making borrowing decisions—especially those using high cost credit.

3.7 *Steps should be taken to improve the credit history data that is available through credit referencing agencies such as including debts to all high cost credit, rent-to-buy purchases, social housing rent arrears, tax arrears and utilities arrears*

At present, credit referencing agencies do not have various types of data available to them which are directly relevant to the types of lending that credit unions are engaged in. Without information on high cost credit, rent-to-buy purchases, social housing arrears, utilities arrears and tax arrears, credit unions struggle to make responsible lending decisions and individuals predominantly using these kinds of credit are unable to build a credit history. These gaps should be addressed as a matter of urgency if credit unions are expected to lend responsibly to those otherwise excluded.

3.8 *The OFT should collect more data from the home credit and high cost credit markets for robust market analysis*

Too little is known about the home credit and high cost credit markets. The Competition Commission inquiry half-way through the last decade has been the only comprehensive analysis of the market and since that time there have been a variety of significant developments such as the advent of US-style pay day lending and the collapse of several large home credit companies. It is very difficult to assess needed interventions in this market without full, comprehensive data on it and therefore a commitment to regular market analysis should be put in place.

3.9 *Steps need to be taken to increase the capacity of social lenders, such as credit unions, in order to disrupt the activity of high cost creditors that suck funds away from the poorest communities. Plans for a back office system for credit unions could see a step change in the sector in this regard*

Credit unions and social lenders are often the only source of affordable and inclusive financial services available to those otherwise excluded from mainstream financial services. If we are to ensure that everyone in society has access to credit on fair and affordable terms, the credit union sector must be assisted to grow in line with its internationally-proven potential. In the US, Canada, Ireland and Australia more than one quarter of the population belong to a credit union. Legislative reforms to the Credit Unions Act have recently been approved by Parliament and this will benefit the development of the sector greatly. However, it is vital that support continues. The Department for Work & Pensions is currently considering whether and how to invest an earmarked £73 million credit union modernisation and expansion fund and ABCUL proposes that some of this be used for the development of a suite of centralised back office services which would provide the sector with economies of scale and scope which would see a step change in the sector's development. Without a significantly strengthened credit union sector we have significant concerns that measures to cap the costs of high cost credit could push people into the hands of unlicensed lenders or loan sharks.

3.10 *Penalty charging for current account services needs to be reformed and made more transparent—the Credit Union Current Account, for example, charges a transparent monthly or weekly amount to cover account administration costs rather than funding through penalty charges which research has shown is favoured by those on a low income*

The "free when in credit" model of transactional banking is unfair. Whilst the majority receive their transactional banking free of charge, those on the lowest incomes are made to pay towards the administration costs of the whole transactional banking system through penalty charges that they struggle to avoid because of their low income level. The Credit Union Current Account (CUCA), on the other hand, is structured so that all account holders pay a weekly or monthly fee towards account administration and, in return, are given greater flexibility in managing their income and expenditure and are not charged enormous fees for missed payments. Independent research by Liverpool John Moores University has shown that this is preferred by those on a lower income. It is unacceptable for those on the lowest incomes to subsidise the services enjoyed by those on the highest and this needs to be addressed robustly to ensure a better deal for consumers.

3.11 *The court system for enforcing debts should be reformed to make it more cost-effective perhaps through the creation of a non-court statutory debt resolution system which would be more efficient and leave the courts free to deal with points of law*

At present the court system for enforcing unpaid debts is far too expensive for credit unions to deal with—especially where financially inclusive activity is concerned. For example, for a £300 loan over 6 months at the maximum credit union interest rate of 26.8% APR, the revenue generated is around £20. But the court debt enforcement system is very expensive and, even where a court order is granted, can be difficult to enforce. We feel that consideration should be given to other forms of statutory debt enforcement which are more efficient and cost-effective so that credit unions can enforce debts effectively.

3.12 *Full recognition is required for credit unions and other ethical lenders in the debt and insolvency system. Unable to "price for risk" due to the statutory interest rate cap and working on tight profit margins through charging affordable interest rates means that increasing bad debt and insolvency is jeopardising the role credit unions are able to play in supporting the financially excluded. This could involve:*

- an obligation to approach credit unions to re-negotiate terms before filing for insolvency;
- the Common Financial Statement should include a credit union savings and/or loan repayment trigger figure alongside other necessary outgoings; and
- a formal acknowledgement in debt advisor and Insolvency Service guidelines that insolvency can jeopardise credit union membership and may leave an individual without access to affordable credit and, therefore, should steps be taken to retain these services.

Credit unions are seeking to provide an affordable credit service in a market which is dominated by high cost alternatives. The effect of this is to mean that profit margins on lending are extremely tight for many of those "financially excluded" that credit unions serve. And whilst the Government is keen to promote the role credit unions play in this regard, most notably through initiatives by DWP, at the same time credit unions are experiencing a much tougher bad debt environment with insolvencies and debt management plans increasing for their demographic. Until now there has been no formal recognition of the fact that, where a credit union member makes themselves insolvent or offers a nominal repayment in a structured debt management plan, unlike with commercial lenders who can price in risk through not being subject to an interest rate cap or not having any scruples about charging hundreds or thousands of per cent interest, credit unions lose a chunk of their members' funds which takes several similar loans to make up. The increasing incidence of this means that over time, credit unions are finding it more and more difficult to serve this market. The suggested actions above would greatly improve the situation for credit unions in recognition of the vital support they provide to some of the most excluded people in society and the fact that Government is both encouraging credit unions to intervene in this market but at the same time penalising them for doing so.

3.13 *As routine, a debtor's circumstances should be reviewed regularly as part of an insolvency so that, should the circumstances improve, more of the debt be repaid as opposed to written off*

Too often our members find that debtors' financial circumstances improve but they do not either resume payments or increase the level of payments made. In the Scottish Debt Arrangement Scheme system, regular reviews are conducted to assess an individual's circumstances on an annual basis and changes made to the Scheme accordingly. This should be considered in England and Wales, also.

3.14 *The Scottish Government's proposed Debt Arrangement Scheme system should be studied for replication in the English and Welsh jurisdiction—features such as the provision to the debtor of the full implications of different debt solutions, open disclosure of the full cost of a solution and obligatory signposting to free debt solutions provided by Citizens Advice or the Consumer Credit Counselling Service should all be considered*

As above, the Scottish Debt Arrangement Scheme system has several key features which would be significant improvements upon debt solutions in England and Wales and would redress the imbalances in the system which favour the debtor at present and would also provide concrete safeguards to protect vulnerable consumers from unscrupulous debt solution providers.

3.15 *Credit unions report that there are a great many unscrupulous debt management and insolvency practitioners operating in the UK and that they can charge excessive, hidden fees which leave individuals no better off after making payments for long periods. Full, statutory regulation of debt management companies is required as proposed some years ago by the Ministry of Justice*

The Ministry of Justice has deferred the question of whether to introduce statutory regulation of debt management companies until after the Government's debt and credit review and we would like to see this come about as a result of the review.

3.16 *The routine "maxing out" of Common Financial Statement trigger figures should be effectively enforced against—too many debtors are encouraged to pay as little as possible towards their debts through inflating their monthly expenditure*

We recognise that this is not a legitimate practice and is discouraged by national bodies and authorities but many of our members continue to see the practice taking place.

4. The Government's response and conclusion

4.1 We recognise that the Government has not responded on a number of issues contained in the original document and is allowing the recently introduced Consumer Credit Directive to bed in before proposing any further action on a number of issues raised in the original consultation. We look forward to further action being taken.

4.2 The Government's commitment to reviewing the case for a total cost of credit cap—as opposed to an interest rate cap—is a welcome one however we continue to be concerned about the impact this might have upon individuals without proper, scaled-up alternatives being available. Any action in this area needs to run hand in hand with initiatives to scale up third sector lending and we look forward to the DWP's decisions in this area.

4.3 Elsewhere, the Government has asked the OFT to get tougher on debt management companies and other related areas but, whilst there have been come high profile actions, we hope that full sector-specific regulation will be considered once time has been given to assess recent actions.

4.4 We would happily provide further information and evidence on any of the areas covered in this document.

14 November 2011

Written evidence submitted by the British Bankers' Association (BBA)

1. The BBA is the leading association for the UK banking and financial services sector, speaking for 201 banking members from 50 countries on the full range of UK and international banking issues and engaging with 55 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts for UK customers and contributing £50 billion annually to UK economic growth.

Executive Summary

2. This submission outlines a number of issues identified by BBA members with regard to the current Debt Management landscape and offers practical steps which could be taken, during the current programme of institutional reform, to improve the debt management landscape for the benefit of consumers, creditors and the wider economy.

The issues:

— The debt remedy regime is fragmented, with numerous remedies administered by a number of different Government bodies, including the Insolvency Service, Ministry of Justice (MoJ) / HM Courts Service (HMCS) and the Office of Fair Trading (OFT).

— The current regime generates unnecessary costs and bureaucracy for creditors and regulators. These impact on the public purse through duplicated statutory procedures and administrations, and on the wider UK economy by excluding consumers from normal economic activity.
— Due to uncertainty and inconsistency in the debt management process, creditors must compete to collect and therefore concentrate resources on collection rather than early intervention and rehabilitation.
— Consumers can be overwhelmed by the myriad of sources of advice and resolution available. Many offer a valuable service, but poor practices and exploitation of vulnerable consumers is evident.
— Creditors do not enjoy a level playing field. Debts are regarded with different levels of priority and not all creditors contribute fairly and proportionately towards the funding of advice and debt management.

The solutions:

— The Money Advice Service (MAS) should collect and analyse comprehensive data on the quantity, quality and performance of debt advice and remedies so that resources can be directed to where they are most effective.
— The MAS should create and host a single debt-advice gateway for consumers seeking help, advice and rehabilitation.
— More interventionist regulatory action should be taken against unscrupulous debt management practices, such as withholding payments; flipping customers to different remedies; levying disproportionate upfront fees.
— All debt management services should be funded on a polluter-pays basis across all creditors—financial and non-financial.
— All unsecured creditors should have an equal footing and thus share a common interest in the consumer's debt remedy and rehabilitation.
— In the longer term, a simplified governance model should be established, with a single regulatory body responsible for administering all formal and informal debt remedies.
— A simplified governance model should rationalise and simplify the formal and informal debt remedies available.

The Current Debt Management Landscape

Background

3. Personal debt in the UK stands at nearly £1.5 trillion[10] of which around 85% is made up of mortgage borrowing. However, the government's figures show that in 2009–10[11] 88% of households in Britain were either not in debt or had debts which were manageable.

4. Nevertheless, the fee-charging debt advice sector has grown rapidly in the last decade and by the end of 2010 there may have been as many as 562,000 fee-charging plans in operation (compared to around 220,000 in the free advice sector) with fees paid for debt management services reaching within the region of £250 million.[12]

5. One of the unintended consequences of the increasing commercialisation of the debt market, by the growing number of debt management and claims management companies, is the "moral hazard" of creating a culture where repayment of debts is optional. Credit has long been provided on the assumption that the repayment of debts is a moral obligation, which is prioritised over many other forms of spending. Where this breaks down and borrowers do not repay, the consequences are ultimately passed on to other borrowers in the form of more expensive and less accessible credit.

6. Effective debt management enables an efficient functioning credit market, which is crucial for a prosperous economy. It is essential that the needs of both debtors, for effective debt relief, and of creditors, for the best possible returns, are addressed. Under current arrangements, neither objective is being met.

7. The current debt remedy regime is fragmented, with numerous debt remedies administered by a number of different Government bodies, including the Insolvency Service, Ministry of Justice (MoJ)/HM Courts Service (HMCS) and the Office of Fair Trading (OFT). At present, there are a number of debt remedy procedures, ranging from informal arrangements such as token payment plans and Debt Management Plans (DMPs); to formal insolvency procedures such as Individual Voluntary Arrangements (IVAs), Debt Relief Orders (DROs) and bankruptcy; as well as formal court-based remedies such as Administration Orders and Charging Orders.

8. Over indebted consumers are faced with a multitude of free or fee charging choices for advice and resolution. Many are reputable, but some are not and debt advice is sought at a very distressing time for the individual. Whilst reputable sources of free debt advice exist; all have limited resources. This can lead to over

[10] http://www.creditaction.org.uk/debt-statistics.html
[11] *Credit, Debt and Financial Difficulty in Britain 2009/10,* BIS report.
[12] Payplan, April 2010.

subscription (eg anecdotal examples of 12 week waiting lists at Citizens Advice Bureaux) or a lack of sufficient marketing and promotion to compete with the brand awareness created by the heavy marketing of fee-charging advisors.

Debt Advice

9. Whether advice is free or fee-based its quality and consistency is variable. When debtors with similar financial circumstances seek help they can be given different advice and solutions depending on which organisation they have approached, which agency, branch or bureau of the same organisation they have used and even which advisor they have seen. This situation is exacerbated within the commercial debt management sector, given the large number of Debt Management Companies and 3rd party intermediaries which exist.

10. For creditors, this inconsistency manifests in receiving information and proposals (of variable quality and accuracy) from advisors, using different systems and formats; applying different interpretations to evidence and conveying different expectations of what the appropriate solution should be for the customer's circumstances. It is hard for creditors to model recovery rates in an environment where a debt advisor does not automatically advise the best course of action for the consumer.

11. Funding of free debt advice is another area where inconsistency of approach and inefficient use of resources has an impact. Not all creditors, who may benefit from the provision of appropriate debt advice, currently contribute towards the costs of that advice. Although transfer of responsibility for coordinating debt advice to the Money Advice Service is likely to result in all FSMA regulated financial creditors being levied to support debt advice, this will not capture all unsecured credit providers and will not tackle the obligations that non-financial creditors, such as central and local government, telecoms and utilities providers, should have to meet a proportionate share of the costs.

12. For those who currently contribute voluntarily to the provision of free debt advice the benefits, although real are not quantifiable. The performance of advice agencies is not measured by outcomes and there is little evidence available to demonstrate value for money or efficient deployment of resources.

The remedies

13. We currently have a range of informal, formal and court-based remedies to over indebtedness. Each has its own merits, but remedies can often be applied to inappropriate circumstances and collectively they contribute to the complexity and inconsistency of the current landscape. At present no single stakeholder in debt management has a complete picture of the consumer and creditor experience. For instance, data is not consistently collected or interrogated on the performance of DMPs and no single resource exists to capture, analyse and compare the success or failure of different remedies or the movement of consumers from one remedy to another, or into and out of the debt-cycle.

14. Debt Management Plans (DMPs) are by far the most prevalent repayment remedy, with an estimated 120,000 established in 2010 alone. DMPs are designed to be used by customers who find themselves in financial difficulties due to a fall in available income. Its aim is to allow customers to avoid a more formal debt solution and either to move back towards normal full repayment in the short term or to pay off outstanding debts in full over a longer more manageable period. However, the experience of creditors and DMP providers suggests that the majority of DMPs are broken and that breakage usually occurs within the first two years of the plan. It is therefore evident that a DMP is not the appropriate solution for most consumers.

15. At least 75% of all DMPs are set up and run by commercial debt management companies who will usually charge both upfront fees and an ongoing management fee for the plan. These fees are paid by the indebted customer and do not contribute to the debt repayment. In most cases the debt management company will cover its costs and generate the majority of its income from the initial set up fees, which are typically the first three months of repayments, but can be up to six months of the customer's contributions. It is therefore arguable that the commercial DMP provider has no interest in whether the plan succeeds or not and little incentive to support the customer after the initial fees are paid.

16. Front-loading charges may minimise the debt management provider's risk but it does not necessarily deal with the consumer's difficulties fully and impairs the creditor's recovery models. Understanding the impact on the creditor is important, as it makes it harder for them to manage their capital efficiently and can have a detrimental effect on lending to the economy.

17. There are three main formal insolvency procedures for consumers in England and Wales. Individual Voluntary Arrangements (IVAs), Debt Relief Orders (DROs) and Bankruptcy. DROs and Bankruptcy are appropriate devices for writing off debt when there is no real prospect of recovery and IVAs offer a form of debt repayment plan, more structured than a DMP, with an element of debt forgiveness in return for a proportion of the customer's equity. An IVA can be a useful insolvency tool and its use, when appropriate, is welcomed by creditors and insolvency practitioners. Stakeholders however are rightly concerned when an IVA is incorrectly identified as the appropriate tool or when an arrangement is only established after the customer is "flipped" from an informal plan and hit with a second round of set up and management fees.

18. It is clear that a debt remedy cannot exist to cater for every single incidence or situation but it should be possible to create a small number of debt remedies for particular generic situations that are flexible enough to deal with each specific individual's circumstances.

Regulatory barriers

19. As the regulatory authority for the Consumer Credit Act, the OFT assumes responsibility for the regulation of debt management providers and for the actions of licensed creditors in dealing with customers in financial difficulties and their advisors. The OFT requires that creditors treat all third party customer representatives equally and so does not allow creditors to offer more favourable terms to the most reputable free or fee-based advisors or to decline to do business with debt management providers that the creditor knows or suspects of treating customers in a manner contrary to the customer's best interests.

20. Although the OFT has taken decisive action against licensed debt management providers who it has found to be non-compliant with its debt management guidance (including revoking the licenses of 35 providers earlier this year). BBA members believe creditors are in an ideal position to identify disreputable providers and could achieve a significantly positive shift to the market if allowed to prevent unscrupulous businesses from exploiting vulnerable consumers.

The current approach to collections

21. Inconsistencies in the quality and outcomes of advice and debt remedy create uncertainties for creditors in anticipating the likelihood of successful debt management and rehabilitation and therefore the likely level of loss and recovery. As a result creditors compete to collect and some are therefore inclined to demand what they can, when they can rather than to take a more holistic and long term view.

22. Creditors' resources are therefore more focused on collections activity following arrears and default and less attention is paid to proactive and preventative intervention (although this is improving through the industry's voluntary Lending Code). As each creditor will expect other creditors to also be competing to collect from the customer, this creates a self-perpetuating cycle and is not conducive to a more considered and supportive plan of managed debt repayment.

A better way forward

23. It would be in the interests of consumers, creditors, advice agencies, reputable debt management providers and the government for a better, more sustainable debt management landscape to be created. Although the government declined, in its response to the BIS review of credit and debt, to countenance significant action, the BBA believes that a number of coordinated measures are possible which would collectively address the issues identified above and create significant benefits for consumers, creditors and regulators.

Use the Money Advice Service to improve debt advice

24. In July the government announced that the MAS would assume responsibility for coordinating debt advice. MAS will invite tenders for the delivery of free debt advice services and is seeking to develop a sustainable funding model, which is likely in part or whole to raise funds via a levy on FSMA regulated firms. It is also likely to use its dedicated website to provide debt advice information and tools.

25. However, we believe there are potential opportunities for MAS to use its powers and influence to affect the wider landscape of debt advice and debt management. If raising funds through an industry levy MAS will have a statutory obligation to get value for money and to demonstrate that value. In offering tenders for debt advice it could therefore oblige debt advice agencies to be resource efficient and to evidence their use of funds to achieve outcomes-based performance.

26. A more efficient and results-led approach to debt advice should make more efficient use of alternative channels of advice (for instance internet and telephone provision) and should ensure a more standardised approach to providing advice, where common processes, systems and calculations are used and debtors with similar circumstances receive similar help and similar remedies.

27. We believe MAS should take a broader view of debt management, than simply those agencies it will fund to provide advice and it should act as a repository for the collection of data on all aspects of debt management. This would include how advice is used and what works and what doesn't (in terms of both advice and remedy). Not only would this allow the MAS to direct resources to where they are most needed and effective, it could also assist in shifting the wider debt management market towards those practices which are shown to be most beneficial to consumers, advisors and creditors.

28. In addition, the BBA believes that the MAS should act as a gateway for consumers into debt advice and debt management. Currently consumers can be overwhelmed by the number of agencies or firms which offer free and fee-based debt advice and debt solutions. However, if the MAS, as a recognised independent body, with marketing and branding expertise, were to promote itself as the portal into reputable advice and support it could benefit all stakeholders.

29. A single portal through which all free sources of internet, phone and face-to-face information and debt advice are accessed would simplify the current process and be the focus of promotion and awareness-raising by stakeholders in the debt environment. The portal would offer advice and support across the life-cycle—in essence an expansion of MAS' current role—and it could reduce the risk of stigma associated with being a pure debt management source of advice. The portal could filter enquirers towards the most appropriate types and channels of information, thus using resources more efficiently, and could also act as the starting point for any subsequent debt management and rehabilitation activity.

Allow creditors to avoid unscrupulous debt management providers

30. Creditors, consumer advocates and commentators all share concerns about practices employed by some licensed debt management companies. These practices include withholding payments from creditors in the hope of later offering a low full and final repayment; flipping customers from one inappropriate remedy to another, and levying disproportionate upfront fees which act as a disincentive to an ongoing supportive relationship.

31. Under current regulatory guidance, creditors have no option but to consider an approach from a 3rd party mandated by a consumer to act on their behalf, even if the creditor suspects that the 3rd party will not be compliant with its obligations to the consumer. This allows bad practices to continue and we believe creditors should be given the regulatory protection to decline to deal with unscrupulous debt management providers, whilst offering consumers alternative and more appropriate support.

32. We further believe that accurate and complete collection of data (by MAS—as outlined above) on the remedies provided to consumers and their outcomes would allow a regulator to take a more proactive and intrusive approach to the activities of debt management providers, both exposing and mitigating bad practices as they emerge.

Create a level playing-field for creditors

33. The BBA is a strong believer in the "polluter-pays" model of funding debt management. This means that the owners of each debt held by the consumer, whether financial or non-financial, public or private should contribute towards the costs of advising and supporting the consumer; administrating and collecting repayment and/or insolvency, and rehabilitating the consumer back into the mainstream.

34. At present, we have some form of "polluter-pays" model through the Fairshare approach used by both Payplan and the Consumer Credit Counselling Service (CCCS). However, not all creditors take part and some of those that do place a cap on their commitment. We believe that to develop a more consistent and efficient debt management process there needs to be a common commitment from all financial and non-financial creditors to transparently and proportionately contribute towards a debt management business model which incorporates a "polluter-pays" approach whilst allowing participants to compete.

Simplify debt governance and remedies over the longer term

35. To address the fragmented governance regime will take time, but it should be reviewed and streamlined to create a more efficient, responsive and dynamic mechanism for regulating the market. A single body responsible for legislating and administering all formal, statutory and court-based debt remedies would improve the efficiency and simplicity of the debt management framework and make it easier to mould as future needs emerge.

36. This single regulatory body might then enshrine good practice, outlaw unscrupulous activities and require common standards and a common approach from all advisors and creditors in one suitable regulatory form.

37. Additionally, using data collected and analysed to fully understand the market, it would be possible to rationalise and re-engineer the range of formal and informal debt remedies into a dynamic, streamlined and complimentary suite, within which a consumer could move during their period of debt repayment as and when their financial circumstances dictate.

Conclusion

38. The BBA believes that creditors, consumer advocates and regulators share a common goal of creating a more consistent, effective and efficient debt management landscape. Although the government has indicated that it sees no strong evidence to justify an urgent restructuring of the framework but instead proposes a series of minor initiatives, we believe that a more holistic and comprehensive set of measures are appropriate and achievable.

14 November 2011

Written evidence submitted by the Citizens Advice Bureau

Summary

— Citizens Advice believes that there are some good proposals in the Government response on personal insolvency, but in general we are disappointed that the Government has missed an opportunity to improve the options and protections available to people in financial difficulties. For instance Citizens Advice would have liked to have seen a firm commitment on more breathing space for people in temporary financial difficulties and a clear direction of travel on access to protection and debt relief for people currently unable to access either an IVA, bankruptcy or a Debt Relief Order.

— Citizens Advice continues to see problems in consumer credit markets and is particularly concerned that the most financially vulnerable are not being protected against exploitative practices.

— We highlight problems with debt management, credit broking and payday lending to show how ineffective consumer credit regulation and a flawed system of debt remedies combine to make debt problems worse for some of the most financially vulnerable consumers.

— We believe that the Government should rethink its decision not to redevelop the debt solutions landscape to provide a better, more coherent system. In particular, the Government should start work on implementation of the statutory debt management plan scheme that Parliament has already approved in the Tribunal, Courts and Enforcement Act 2007.

— We urge the Government to quickly improve a consumer credit regulation regime that is failing to stop unscrupulous firms from preying on vulnerable consumers.

— We urge the Government to take action to stop bank charges spiralling out of control for people in financial difficulties and to stop store card promotions being linked to retail offers and discounts.

Introduction

Citizens Advice welcomes this opportunity to submit evidence to the Business, Innovation and Skills Committee inquiry on Debt Management.

The Citizens Advice service is a network of 394 independent advice centres that provide free, impartial advice from more than 3,500 locations in England and Wales, including GPs' surgeries, hospitals, community centres, county courts and magistrates courts, and mobile services both in rural areas and to serve particular dispersed groups.

In 2010–11, the Citizens Advice service in England and Wales helped over two million people with over seven million problems. This included 550,000 people who made 2.3 million enquiries about debt related problems.

Over 960,000 of these enquiries were about consumer credit debts and ancillary credit services. Another 285,000 enquiries were about insolvency options (bankruptcy, Debt Relief Orders and Individual Voluntary Arrangements). A further 132,000 enquiries concerned non-debt related financial products and services, including 3,155 problems about debt management and credit repair companies.

We believe that this experience makes us well placed to comment on the issues covered by the Government's consumer credit and personal insolvency review.

Background: Protecting Financially Vulnerable Consumers

The foreword of the call for evidence document *Managing borrowing and dealing with debt* sets out the Government's commitment to the reform of financial services regulation and "to curbing unsustainable lending and to the strengthening of consumer protections, particularly for the most vulnerable".

Citizens Advice welcomes this commitment. But we believe that the Government now needs to ensure that both consumer credit regulation and the system of debt remedies to do more to support and protect financially vulnerable consumers.

Citizens Advice Bureaux continues to see cases where people in severe financial difficulties are being ripped off by unscrupulous firms or offered inappropriate solutions to deal with their debts. For instance:

Mis-sold Debt Management Plans and Individual Voluntary Arrangements

We continue to see problems with mis-sold debt management plans and individual voluntary arrangements. In some of these cases this people have been sold inappropriate or unsustainable products. In other cases people have paid very large fees for a service that has provided little or no help or has actually made their debt problems worse. A few examples from hundreds of such cases reported by bureaux in the last few months help to illustrate the problem:

> A CAB in the North East of England saw a 25 year old woman who, with her husband had been struggling financially and had contacted a company for assistance. They thought they were paying £150 per month to an individual voluntary arrangement but it was a debt management plan, with £30 administration fees. The debt management company took the money from her bank account

every time she was paid using her debit card number. She told them that this was causing her financial hardship and she was falling behind with her rent and council tax. As she was an introductory tenant with a social landlord, this had serious implications, as if she were taken to court for rent arrears, the court would have to grant possession to her landlord, even if she could pay off the arrears. But the debt management company refused to cancel or amend their plan; they told her to borrow money from family or friends. The woman had a young son and was frightened of losing her home.

A CAB in Yorkshire and the Humber saw a retired couple whose income came from pension and disability benefits. They were successfully repaying a bank loan at £130 per month. But they received sales marketing calls from a debt management company that hoodwinked them into entering into a debt management plan, which entailed a set up fee of £333 and a monthly fee of £30 simply to service the debt they were already repaying. In addition they were asked to sign a waiver to the statutory cooling-off period.

Another CAB in Yorkshire and the Humber saw a married man who had with three children and was working 16 hours per week as a chef. He also cared for his wife who was severely disabled and in receipt of disability living allowance. They also received tax credits, had no assets and lived in a council rented property. Despite this he was sold an IVA in 2010 to deal with his debt problems. The provider carried out a yearly review and requested a further 50% of his income. This meant the IVA instalment increased to £600 per month, including his wife's disability benefits and their child benefit being treated as available income for the IVA. This left them with little disposable income and a debt remedy that was not in their best interests.

A CAB in the South West of England saw a 43 year old woman with dependent children who was working and living in privately rented accommodation. After her home, which had been purchased under the right to buy scheme, was repossessed in 2009 she ended up with debts of around £35,000. The debt was exacerbating her depression and so she contacted a debt help company to discuss the possibility of bankruptcy. The company gave her misleading information about the costs of bankruptcy and sold her an IVA instead; even though she met none of the criteria that would make an IVA a suitable option rather than bankruptcy. She had no assets, no reason to avoid bankruptcy from the point of view of her work or social standing and her income was insufficient to maintain IVA payments. After taking out the IVA she fell behind with council tax and fell into rent arrears. Her debt problems got even worse.

Unscrupulous Credit Brokers Ripping Off Financially Vulnerable People

In March Citizens Advice published an evidence report *Cashing in* that highlighted problems with sub-prime credit brokers and debt management companies. We were particularly concerned about firms cold calling consumers and/or taking up-front fees (sometimes by unauthorised deductions from a person's bank account) for a loan finding service. In many of these cases the person did not get the loan and was unable to get their money back. In over 40% of the cases reported by bureaux the person was under financial pressure when they approached the credit broker.

Research by the Office of Fair Trading in response to our super-complaint found that these practices were widespread.[13] The OFT estimated that in the last year around 12% of consumers had been contacted unexpectedly by a firm offering to help them help to find an unsecured loan. The OFT also estimated that in the last year around 270,000 consumers had paid an up-front fee, typically between £50 and £70, to a sub prime credit broker in the expectation of getting a loan. The same estimates suggested that 45% people paying a fee were not offered a loan and 36% were offered a different loan that that advertised. The research indicated that as many as two thirds of people that should have been entitled to a refund did not get one.

The OFT concluded that "there are a number of businesses in the unsecured subprime credit brokerage market whose business models are based on taking upfront fees for a service which they are unlikely to be able to provide". Here we also note that the OFT has recently announced enforcement action against one of the largest credit brokerage firms; issuing a *minded to revoke* notice on Yes Loans and associated companies in 27 October. While Citizens Advice welcomes this action by the OFT, the problems we see involve many firms and previous enforcement action by the OFT does not seem to have cleaned up this market sector. Five months on from our super-complaint and Citizens Advice continues to see cases showing how bad practices by credit brokers are still causing hardship to financially vulnerable people.

A CAB in the East Midlands saw a 49 year old man who was recovering from a bi-polar disorder and was supported by a community psychiatric nurse. He lived on his own in social housing and worked part-time. He said that he had lost £495 that had been taken from his account by seven different credit brokerage companies. He never received a loan or refund from any of these companies and felt that they had "ripped him off".

A CAB in the South West of England saw an 18 year old man who was a serving soldier and still in training. He had applied on the internet to a credit brokerage firm who charged a fee and find him a loan. But it appeared that his details were passed to a number of other brokerage companies without his permission resulting in three companies charging him administration fees totaling £155.

[13] Marketing and charging practices in the sub-prime credit brokerage and debt management sectors. Response to the super-complaint by Citizens Advice. (2011) Office of Fair Trading.

> Another CAB in the South West of England saw a 19 year old woman who was homeless and applied to an online company for a loan online to help her deal with some debts. She cancelled within the 14 day limit but was still charged £68 and then another £68 by a similar company who she had had no contact with. She could only assume that they got her bank details from the first company.

Citizens Advice believes that the law should be changed to prohibit cold calling by credit brokers. We also believe that the law needs to be changed to prevent credit brokers from taking a free in advance for actually finding a consumer a loan. The current Consumer Credit Act protections on the return of fees by brokers is not working to protect consumers from this abuse.

People using High Cost Credit to Deal with Financial Difficulties

We estimate that around 16% of people seeking advice from the CAB service about debt problems have one or more high cost credit debts. Furthermore, in recent years we have also seen an increase in the proportion of CAB debt clients who have one or more payday loans, rising from an estimated 1% in Q1 2009–10 to 4% on Q1 2010–11. This probably reflects the growth of the sector over this period. Citizens Advice sees a number of business conduct issues with payday lenders and other high cost credit firms. Indeed we continue to see evidence of unfair practices in all sections of the consumer credit market causing detriment to consumers.

But here we will highlight a particular problem of people using high cost short term credit to try to deal with existing financial difficulties. For instance, analysis of a sample of over 27,000 CAB debt clients suggested that people who had one or more payday loans had more debts than other unsecured loan borrowers and were more likely to have one or more debts with a debt collector or bailiff. Given that these are short term agreements, there is a strong suggestion that people were using these payday products to try to deal with their financial difficulties. However as the examples below illustrate, for some people these loans were unaffordable, inappropriate and only made their financial difficulties worse.

> A CAB in the South East of England saw a 43 year old man who was married and had three children. He was working and had very good take home pay. He owed around £11,000 on loans and credit cards and had kept up with the repayment on this. But he became overstretched and started taking out payday loans. He had eight of these totaling around £5,000. Money was taken directly from his bank account and he was getting deeper and deeper into debt and continued to take out further payday loans to cover his expenses.
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> A CAB in the West Midlands saw a 28 year old man who was an agency worker on temporary contracts and on a low income. His partner had mental health problems and was unable to work. The couple had a two year old child. He came to the bureau for assistance with a variety of non-priority debts including a number of payday and text loans, taken out to pay off the previous ones. The companies dealt mostly by email and mobile phone. There were 13 creditors in all. He was also trying to deal with priority debts and had little spare income to deal with credit debts. He said he had been harassed by some of these companies and threatened with bailiffs.
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> A CAB in the South East of England was visited by a woman who was on a low income and had numerous debts. She took out a pay day loan online which was originally £350. She had to pay back £479 a month later which she did not have the necessary income to do. She found that she was now unable to make payments on other debts as the interest charged on the payday loan was so high that it left her with no disposible income. This had led her to fall further into debt as penalties and interest charges were added to her other debts.

We could cite more sectors, products and practices producing detriment for financially vulnerable consumers. But we believe the cases described above illustrate the two key problems that this credit and debt review needed to address.

- Consumer credit regulation is failing to protect consumers and the most financially vulnerable consumers in particular.
- People in financial difficulties do not always have a clear route to appropriate help with their debt problems.

These cases also show how these problems interact. Poorly regulated lending and collections practices can cause or contribute to unmanageable debt problems. People struggling to manage their debts can become be very vulnerable to unfair practices by firms offering credit or debt management services as a way of dealing with debt problems. This is why CAB money advisers often describe people as falling into a "cycle of debt" or a "debt spiral".

The Government Review

As a result we believe that the Government has asked some of the right questions, both in the credit and personal insolvency strands of this review and in the related work on the future of consumer credit regulation.

The Government has only responded on the personal insolvency strand so far. An announcement is expected very soon on some of the issues raised in the credit side of the review. A statement on the broader future strategic direction of consumer credit regulation is expected in the new year.

Our reaction and comments on the personal insolvency review is set out below. This is followed by a summary of our view on what needs to change to ensure that the consumer credit regime provides better and more consistent protection for vulnerable consumers. Finally we give a view on the change we believe is necessary in respect of some of the key specific issues raised in the credit side of the credit and personal insolvency review.

Announcement on Future Money Advice Provision

Citizens Advice warmly welcomed the Government's recognition of "the importance of ensuring that consumers have access to free and impartial advice on dealing with their debts". This recognition is extremely important for the CAB service, at a time when the future funding of our debt advice services has been uncertain.

The Government had previously announced a decision to continue funding the fact-to-face debt advice project for this year. Last year this funding meant that projects managed by the CAB could employ around 350 debt advisers (full time equivalent) who were able to help 71,467 people with their debt problems. However the longer term future of the face-to-face debt advice project is still to be decided. We would also point out that the legal aid budget for debt advice is due to fall by 75% from 2013, figures from the Ministry of Justice suggest that the number of people helped with debt problems will fall by 105,000 as a result.[14]

As a result Citizens Advice was particularly pleased that the Government announced, in this review response, that it is working to move provision of debt advice services onto a more sustainable footing in the future and has asked the Money Advice Service (MAS) to take responsibility for the co-ordination of these. MAS has been tasked to develop a model that ensures debt advice outcomes can be delivered in an effective, efficient way. Citizens Advice supports this aim but urges both the Government and MAS to ensure that this model pays particular attention to the needs of consumers who need extra support from debt advice services to ensure that their needs are met. Here we would also point to our 2011 evidence report *Double disadvantage* highlighting the problems faced by disabled CAB debt clients. The report found that creditors were not always or consistently taking proper account of the needs of disabled people and that this was connected to other unfair practices. However the report also found that advice services that are specifically focused on the needs of disabled people could break through these barriers and empower people to get control of their debt problems. The report was based on the experienced of clients of the face-to face (formerly Financial Inclusion Fund) disability project. This was a partnership between Citizens Advice, and four disability organisations[15] where 10 citizens advice bureaux gave advice tailored to the needs of disabled people. The advice delivered by this project had a higher cost per case because of the extra time and resources (such as access to British Sign Language interpreters) required to support the needs of these people. We believe that any future debt advice commissioning model must continue to support and expand such projects.

The Government's Response on Personal Insolvency

Welcome initiatives

Citizens Advice welcomes the following announcements:

— The Government has announced that it will consult on increasing the debt level at which a creditor can petition to make a debtor bankrupt. This level was set at £750 when the Insolvency Act came into force in 1986 and has not been increased since. This is a very low hurdle for a legal remedy with such far reaching consequences for debtors, including the possibility of losing their home because of problems with unsecured debts. However we do not believe that the issue is just about updating this limit for inflation. Here we note that the Coalition Government agreement includes a commitment to "ban orders for sale on unsecured debts of less than £25,000". Citizens Advice strongly supports this commitment, which we estimate would protect around 95% of people form the threat of losing their home because of an unsecured debt. However to be effective this limit would have to extend to the creditor's petition level for bankruptcy.

— Access to basic bank accounts for undischarged bankrupts: In 2010 over 59,000 people were declared bankrupt. In the same year Citizens Advice published a evidence report, *Called to account*, that highlighted the problems that many undischarged bankrupts faced accessing a basic bank account for transactional banking. The report highlights the extra costs that people without access to a bank account face and the hardship this could cause. Many banks are unwilling to offer these accounts, citing their perception of a risk in insolvency law that the bank could become liable by claims from the trustee in bankruptcy in respect of after-acquired property. The Government has responded to concerns on this issue by committing to consulting on ways to amend the legislation to addressed the perceived risk. This is very welcome.

Nevertheless we have concerns about most of the other proposed remedies on personal insolvency and debt remedies generally:

[14] Impact assessment to Ministry of Justice Green Paper response on Legal Aid Reform

[15] The four organisations are: Royal National Institute of Blind People (RNIB; Action on Hearing Loss; Mencap and Contact a Family

A proposed cross industry protocol for debt management plans

The Government's response document highlights how Debt Management Plans (DMPs) caused concerns among all stakeholders. The CAB service receives over 3,000 enquiries a year about debt management companies and Citizens Advice receives hundreds of qualitative reports on the bad advice, poor service and high fees that some customers of commercial debt management firms experience like the ones we cited earlier in this submission.

Indeed the Office of Fair Trading (that licenses debt management companies under the Consumer Credit Act 1974) undertook a compliance review of the debt management sector in 2010. The OFT found "widespread problems in the sector, which are a significant cause for concern" and concluded that it needed to urgently implement an action plan to deal with non compliance and raise standards.

We believe that action by the OFT has had a positive effect. A number of firms have exited the market and the OFT has taken and continues to take enforcement action against others. We have also seen efforts by the main sector trade body to improve standards and compliance monitoring. This is all welcome.

But one year on from the review, Citizens Advice continues to see many of the same problems. Neither the OFT or self-regulation by trade associations has been effective in making the debt management market safe for consumers. We continue to see too many cases of financially vulnerable consumers being exploited by bad practices and unscrupulous firms.

We believe that this is partly a consequence of the commercial debt management sector with there is a core of larger firms and a long tail of smaller firms. Indeed the OFT estimates that between 2008 and 2010 it issued or renewed 3,697 consumer credit licences that included debt adjusting or debt counselling categories. The OFT also highlights the "rapid growth in new entrants into the fee charging debt management sector, operating mainly from internet-based websites".

This describes a sector with low barriers to entry and a large population of firms offering a complex product through distance channels to financially vulnerable consumers. Consumers can also be isolated through unsolicited marketing. Cold calls and unsolicited text marketing is common in this sector, with the OFT estimating that around 26% of consumers were unexpectedly contacted in the last year by a debt management company. The practice of charging upfront fees for "set up costs" is also common so consumers can face significant barriers to switching. We have seen cases where these fees have been exceptionally high as the following examples illustrate.

> A CAB in London saw a lone parent who was struggling to repay her creditors following loss of employment and relationship breakdown. She needed help to deal with her creditors, went on-line, and found a debt management company. The woman paid an up-front administration fee of £1,600 and £40 of the £80 per month she was paying each month was also taken up by their fees.
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> A CAB in the South East of England saw a 44 year old woman who had signed up to a debt management plan in 2009. She had to pay upfront fees of £1,200 and of the £96 monthly payment to them, £50 was their fees. However she was also receiving letters from her creditors threatening legal action. She also had a possession hearing that the bureau said was partly caused by paying the debt management company instead of her mortgage.

The Government has responded to the concerns raised by stakeholders in the call for evidence by proposing a non-regulatory DMP protocol developed in a series of cross industry meetings to set out what all parties can expect from a DMP. The Government intends this to work alongside the OFT's statutory debt management guidance.

Citizens Advice welcomes this initiative and looks forward to working with Government and other stakeholders to develop this proposal. However, we believe that it is likely to have only a limited impact on the problems that consumers are facing in this market. Indeed this proposal appears to be modelled on an earlier IVA protocol developed by the Insolvency Service that had similar aims, but we are still seeing evidence of IVA mis-selling.

While we are always supportive of well targeted self-regulation, we believe that this tends to work best when it applies to a relatively small community of firms who are all members of a trade association and who face significant reputational risk or barriers to exit. None of this seems to apply particularly well to the broader debt management sector at present.

The Government response goes on to say that "to consider non-regulatory approaches does not mean we have reached any final conclusion not to regulate in any particular area of debt advice". Given that existing self regulation in the debt management sector had had little or no effect on the long tail of firms, Citizens Advice believes that the time for firmer action by Government to clean up the debt management sector has long since passed. Furthermore, we would point out that debt management firms are already required to hold a consumer credit licence and are regulated by the OFT. So we are unsure why the Government has preferred self regulation to ensuring that the regulatory scheme that it oversees is working as it should to protect consumers. We would therefore urge action by Government in three key areas as follows.

Specific action to tackle the reasons why consumers end up in bad relationships with debt management providers

In particular we would ask the Government to consider:

- Banning unsolicited marketing by debt management companies to stop firms targeting or isolating financially vulnerable consumers. We note that the OFT found considerable support for this among debt management businesses themselves, with 27 out of 49 firms responding to an OFT survey saying that they believed a ban on cold calling was justified.
- Ban or at least limit the up-front fees debt management firms can charge to address barriers to switching and require firms to refund any upfront fees where a consumer wants to switch to another provider.
- Better control of debt management company promotions to improve price transparency and alert consumers to other options and free debt advice in particular.

Give the consumer credit regulator better powers and resources to both prevent consumer detriment and act more quickly and decisively to deal with problems when they appear

It is important to remember that the debt management firms are required to have a consumer credit licence. We will discuss consumer credit regulation below.

Give people in financial difficulties better options to deal with their debts so they are not drawn into using poor quality debt management firms or taken on high cost credit as a coping strategy

We cover this issue in detail below.

Better Options for Dealing With Debts

The personal insolvency part of the Government's review asked how the current range of debt solutions could be improved. Citizens Advice welcomed the Government's focus on this key issue for two reasons.

Firstly we would point out that Parliament passed legislation in 2007 specifically to update and improve the range of statutory debt solutions available to people in serious and temporary financial difficulties. Part Five of the Tribunal Courts and Enforcement Act 2007 set out four schemes that were developed after a long process of research and consultation:

- An updating of the existing Administration Order (AO) scheme, a very useful and straightforward debt remedy that has fallen into disuse because of an outdated limit on the amount of debt that an applicant could have—£5,000.
- An Enforcement Restriction Order (ERO) that aimed to give people in temporary financial difficulties a period of "breathing space protection" from collection or enforcement activity by creditors.
- A Debt Relief Order (DRO) that provided a cheaper summary access to bankruptcy for people with debts below £15,000 and no income or assets.
- Framework legislation for a Statutory Debt Management Plan (SDMP).

In summary the package had two broad aims:

- Give people in serious financial difficulties the protection and space they need to repay some of all of their debts in a sustainable and affordable way.
- Improve access to debt relief for those that need a fresh start.

Citizens Advice supported both these aims and the package set out in the 2007 Act. However, with the exception of the Debt Relief Order, the package has never been implemented by government.

We appreciate that this legislation was the policy of a previous administration and that the current Government may have different aims and priorities. However the Part Five package did provide some credible solutions to many of the multiple debt problems Citizens Advice has been seeing for many years. As a result we fully expecting this Government review of personal insolvency to properly re-examine this ground.

We are disappointed that the review appears to have done so in only a cursory way. The ERO was dismissed as being "costly to implement" and the Government announced its intention to consult on repealing the AO scheme because it is poorly used.

The only positive point was the announcement that the Government would keep the order making powers for the SDMP scheme in place for the time being. Citizens Advice has been calling for implementation of the SDMP scheme since the Act was passed. Importantly, and contrary to the Government's response, the main point and benefit of the SDMP scheme would not be in providing better regulation of the commercial debt management sector—that remains a job for the OFT and consumer credit regulation to complete.

Instead Citizens Advice sees the SDMP scheme as an opportunity to build a more coherent, more accessible and effective system for helping people in financial difficulties to deal with their debts. Therefore we would urge the Government to do more than just keep these powers under review, but to start actively working on implementation of the SDMP provisions. Our reasons for this are based on the problems in the current system, which are the same problems we raised with Government in the run up to the 2007 Act.

The second reason why we welcomes a thorough review of personal insolvency is because our experience of helping people with serious debt problems tells us that the current system is not working well. Our response to the call for evidence discussed problems with individual elements of the system and with the system as a whole. This are briefly summarised below.

Problems With Individual Elements of the System of Debt Solutions

Negotiating with creditors

The starting point is with the arrears management practices of individual creditors and debt collectors. The huge majority of debt problems are resolved by voluntary agreement between creditors and debtors (or their advisers). Forbearance and voluntary agreement are the foundations of all debt remedies and Citizens Advice welcomes the Government's intention set out in this review to strengthen and build upon on. However Citizens Advice still sees too many cases of people facing overly aggressive collection and enforcement tactics by creditors or debt collectors who refuse to come to an agreement over affordable repayments. Citizens Advice has been working to address this problem in partnership with representatives of some 40 different creditors, both private firms and public bodies. Our report *How to do the right thing* sets out a number of actual good practice examples for creditors helping people to deal with financial difficulties. This is a good example of how cross sector working can produce good outcomes for consumers. We are hopeful that the report will help to spread the good practice examples more widely.

But unfortunately these examples will not necessarily become embedded in the practices of all creditors everywhere and they won't be taken up by unscrupulous firms. Even the best cost-industry voluntary initiatives need to be supported by a strong statutory base to ensure that creditors cannot defect and that bad practice cannot undercut good practice.

Underpinning our work here is the believe that where people are engaging with their debt problems and paying what they can reasonable afford towards their debts they should be protected against aggressive creditors and should not see their debts continue to spiral upwards through interest, fees and charges. But we are still a long way off this point at present.

Debt management plans

We have already discussed business conduct problems in the commercial debt management sector. But all debt management plans also share the same limitations as a voluntary agreement with creditors. As voluntary agreements, debt management plans can give consumers no guarantee that creditors will accept offers, stop collection and enforcement action or freeze interest and charges.

Individual Voluntary arrangements

IVAs are currently the main alternative to bankruptcy where people with debt problems can get some guarantee of protection against their creditors. Indeed the Government cites the existence of IVAs as a reason why there is no need to develop the SDMP scheme.

But IVAs were not originally designed for a mass consumer market and are riddled with problems as a consumer debt remedy. Citizens Advice continues to see cases where people have been sold IVAs that were not suitable or sustainable. The Insolvency Service has recently consulted on improving the regulation in Insolvency Practitioners, following an OFT market study into corporate insolvency. Citizens Advice believes that the regulatory structure for IVAs needs to get significantly better at protecting consumers from unfair practices.

But even with a better regulatory structure this remedy remains problematic. IVAs can be expensive and only debtors with fairly substantial disposable incomes can access them. IVAs are also fairly inflexible to changing circumstances and where an IVA fails a consumer can end up in a worse position than where they started.

Debt Relief Orders

The DRO was designed to facilitate access to bankruptcy for people who could not afford the high fees and deposit needed to apply for bankruptcy. The Insolvency Service were able to reduce the DRO fee to £90 by requiring people to apply through an "approved intermediary" and restricting the scheme to people with debts below £15,000 with no income of assets. The scheme has been effective at supporting people who needed debt relief but could not afford bankruptcy or meet the criteria for an IVA; over 25,000 debt relief orders were made in 2010. We understand that roughly 70% of these were processed by CAB money advisers as authorised intermediaries.

However the debt limit has not been updated since the scheme was introduced and we are starting to see more cases of people who cannot get the help they need because their debts (or income or assets) are over the limit.

> A CAB in Wales saw an unemployed man who lived alone in rented property. He did not have any disposable income and his only asset was a car worth around £500. His credit debts totalled between £15,000 and £16,000. He would benefit from a debt relief order but would not be able to access this strategy if his debts are over £15,000. The CAB considered that this option would have many benefits for him and allow him a fresh start in 12 months. He could go bankrupt, but would not be able to afford the fees.
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> A CAB in the East Midlands saw a woman who owed £16,900. She had had to sell her property as she could not maintain her mortgage repayments and was now in rented property. She could no longer work and had long term health problems including suicidal tendencies. The client wanted to go bankrupt, but did not have £450 for the deposit fee. The CAB had helped her apply for a charitable grant for the fees, but she was still receiving letters from her creditors which she found very distressing. There was no guarantee that the application for a charitable payment would be successful. Although the CAB felt that that bankruptcy was the best option for this client as her recovery period could take years, they noted that if the client had been able to apply for a debt relief order, she would have had this matter resolved by now.

Bankruptcy

Bankruptcy remains the most commonly used form of debt relief. But it is an expensive scheme and the high application fees, currently £700 or £1,400 for a couple with joint debts, are a significant barrier to help for most of the people seeking debt advice from the CAB service.

> A CAB in the South East of England saw a man who was married and had one dependent child aged 16. He had now found work after being sick for a long time, but would still be on a low income. Some years ago, he and his wife had run up substantial debts (over £100,000 between them)—mainly related to failed business. They are no longer increasing their debt but had no means of repaying it. His wife had gone bankrupt a year earlier, but he could not afford the fees especially since the increase in the deposit fee in June 2011.
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> A CAB in Yorkshire and the Humber saw a couple in receipt of means-tested benefits, both of whom needed to go bankrupt. Bankruptcy would be a good option for them, as they had a number of debts, including a mortgage shortfall debt of £47,000. Deductions were being made from their benefit for some priority debts, and they could not afford to make offers to their other creditors. They were very stressed about the situation, but did not have £1,050 for two bankruptcy deposit fees.

Problems With the System as a Whole

So the current "system" of debt remedies is really a group of voluntary and statutory schemes that have developed over time. It is not a coherent, planned whole and as a system suffers from a number of significant flaws. The experience of CAB clients raises the follows issues:

- The statutory debt remedies have explicit or implicit boundary criteria that exclude people from the debt relief they need. As a result people can "fall into the gaps" between these boundaries leaving them without a suitable option.
- This produces the bizarre result that a person with significant disposable income can get both debt relief and protection from their creditors (through an IVA) while some of the most vulnerable debtors cannot.
- There is currently no debt solution that provides support and protection for people experiencing an extended period of financial difficulty. In other words there is no effective statutory "breathing space" scheme, even though this is what many people in financial difficulties need.
- As the solutions do not articulate into a coherent system, there is no easy way for people to move between remedies if their circumstances change. For instance people who have paid for an IVA can find themselves back at square one if the remedy fails.
- The gaps, limitations and failures of the system to support and protect people in financial difficulties creates an opportunity for unscrupulous traders to exploit financially vulnerable people.

What Needs to Change

Given these problems and the back story on the Tribunal, Courts and Enforcement Act we would have expected the Government's response to have set out a clear direction of travel towards a more coherent system that met the key aim of strengthening consumer protections particularly for the most vulnerable.

But this has not happened. Instead the Government response argues that there is little evidence of the need for significant change. Citizens Advice was disappointed by this conclusion and also surprised given our long and continuing experience of the damage debt problems can cause and the way that some people in financial difficulties are being exploited by some traders.

There is much in the response that Citizens Advice strongly supports; we highlighted above our support for some of the specific policy proposals set out in the response and we support the Government's efforts to seek improvements though self-regulation and cross industry working. This is good stuff.

But there is also a missed opportunity here to get to grips with the social consequences of debt problems once and for all. Therefore we would urge the Government to think again on two key points as follows:

- The Government should reconsider the case for structural change to develop a coherent and effective system of debt solutions. The Government needs to work harder at understanding the current problems and developing proposals that move us forward.
- As part of this, the Government should start working on plans to implement a statutory debt management plan scheme. We believe that the legislation is flexible enough to form the basis of a coherent single debt solution capable of providing breathing space, help for people to repay their debts and access for debt relief for those that need it.

Credit regulation

The credit and debt review does not touch directly on the overall effectiveness of consumer credit regulation. This is picked up in the parallel consultation *A new approach to financial regulation: consultation of reforming the consumer credit regime* published by the Department for Business, Innovation and Skills and HM Treasury in December 2010.

The consultation suggests moving consumer credit regulation to the proposed Financial Conduct Authority and putting consumer credit in scope of the Financial Services and Markets Act 2000. Citizens Advice broadly supports this position, as we believe that the current consumer credit regime has neither sufficient powers or resources to deal with the problems we continue to see in consumer credit markets.

Parliament is currently giving pre-legislative scrutiny to a draft Financial Services Bill that proposes to give the FCA more powers to prevent consumer problems in the financial services sector and deal more quickly and effectively with problems that do occur. This follows a long and detailed debate about why we have seen repeated widespread consumer problems with financial services (such as payment protection insurance) and the role of regulatory failure in these problems. But there has not been a similar debate about consumer credit regulation.

That is not to say that there has been no recent reform in consumer credit legislation. There has been significant reform with both an updating Consumer Credit Act in 2006 and the implementation of a European Directive on consumer credit in 2010. Both of these have improved the regulatory regime.

But this has not stopped consumers from experiencing many of the same problems with the conduct of consumer credit businesses. We are still seeing the same old problems with debt management. We are still seeing evidence of aggressive debt collection practices. We are still seeing examples of irresponsible lending. In addition we are starting to see problems with new and sectors and practices such as online credit broking, payday lending and the growth of unsolicited marketing of credit and debt management services.

As a result Citizens Advice does not believe that the consumer credit regulation is currently doing enough to protection consumers and the most vulnerable consumers in particular. Set out below is a brief summary of some of the key changes we believe to be necessary:

- There needs to be better control on firms entering the market and better scrutiny of business models. It is generally argued that low barriers to market entry is good for consumers as it encourages competition. But this is not true of consumer credit, particularly at the margins of the market where rogue firms are finding it too easy to exploit financially vulnerable consumers.
- The regime needs to be less focused on enforcement action against firms behaving badly and more focused on stopping bad practice in the first place. We believe that this requires the same positive rule making powers that FSMA provides for other financial services, including the proposed "product intervention" powers.
- The Consumer Credit Act provides consumers with some important substantive legal rights that need to be retained. However we believe that the regulator need to do more to develop the content of high level consumer protections (like the unfair credit relationship test) through its Part 8 powers and court action if necessary.
- We think that OFT guidance is very good and this part of the current regime needs to be retained. But the guidance need more teeth to be truly effective.
- We believe that consumer credit regulation lacks any real deterrent power—many firms are simply not sufficiently worried about action by the OFT to avoid unfair practices. Therefore we would like to see better intermediate sanctions—the £50,000 fine introduced by the 2006 Act has proved to be a useless deterrent.

— The current Consumer Credit Act explicitly forbids the OFT from ordering firms to compensate consumers for unfair practices. This is a huge weakness to the deterrent power of credit regulation. Firms know that they can profit from bad practice. The power to order firms to review past business and compensate consumers has proved to be one of FSA's most powerful tools.

— The enforcement process is also painfully slow. Firms that the OFT considers unfit to hold a credit licence can continue to trade and cause consumers harm for years as the process winds through layers of adjudication and appeal. The Government needs to speed up the enforcement process to better protect consumers.

— If the Government does decide to transfer consumer credit to the FCA; it will be important that we do not see any gap in consumer protection during the handover period and it will be important that the expertise of the OFT licensing teams is not lost.

Specific Credit Issues Raised in the Review

A response from the Government on the specific credit issues in the review is expected shortly, so we cannot give much comment on this. However we have briefly set out issues we would like to see addressed in the areas contained in the coalition commitments (bank charges and store cards).

Bank charges

Citizens Advice remains concerned about cases where people in financial difficulties see their overdraft debts spiralling upwards because of charges. For instance:

> A CAB in London saw a 55 year-old man who worked part time and needed a bank account. He had difficulty reading and writing. He thought he was getting ordinary free current account but was given a fee charging packaged account instead with features that were no use to him. He lost his lost job and had taken all the money from the account that he had deposited. But he did not realise that he was being charged every month. An overdraft grew and charges added to the account. When he tried to close the account he was told he couldn't because it was in red. The debt had grown to nearly £1,000. This consisted entirely of bank charges.
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> A CAB in the South East saw a 20 year-old woman who had learning difficulties and limited literacy skills. She went into a small unauthorised overdraft in 2010. Charges increased the debt to £600. The bureau wrote to the bank who agreed to write off £450 of this, but the woman had already paid £155 in bank charges.

We want the government to take action to ensure that this problems is addressed. This means getting the banks to be better at spotting people in financial difficulties earlier and putting a more forceful limit on the level charges that can banks can levy on people in financial difficulties.

Store cards

The Government has proposed both cooling off period for store cards. We are not sure that this is workable or a solution that actually meets the problems we see with store cards.

> A CAB in Wales saw a 79 year old widower in receipt of disability benefits and pension credit. He went to a local store to buy a bed costing £179. Although he had the cash with him to pay for the bed, a sales assistant suggested he take out a store card to pay for it instead. The client accepted this but was unaware of the terms of the agreement. On receiving the store card, he cut it up, never using it again. The client had been paying the minimum payment every month for over two years. He had paid a total of £237.72. The CAB was concerned to note that his last statement showed a balance of £239.33. This meant that the cost of the bed was £477, of which £298 were charges.
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> A CAB in the South West saw a 24 year old man who had been working for a chain store for three months. He felt that he had been put under undue pressure to sell their store card, with threats of termination of employment, should he not complete one sale per week. The client said that this was not mentioned during his training, nor in his terms and conditions. He told the CAB that all sales assistants at the store were in the same position.

Instead we would to see measures to stop retail offers being linked to store cards and store card promotions.

16 November 2011

Written evidence submitted by the Consumer Credit Counselling Service

KEY RECOMMENDATIONS

- The Government should protect and promote the provision of free debt advice, especially through strategic partnerships such as the one between CCCS and Citizens Advice (see points 3.5 & 3.6).
- There needs to be much tighter control of the commercial sector, through tougher licensing (6.5), regulation—especially of fees—(5.5), and increased transparency (4.2 & 7.7).
- The Government should look at the success of the CCCS token payments scheme to help provide a breathing space for debtors experiencing a temporary income shock (9.1 & 9.2), particularly in light of the high number of financially vulnerable people.[16]
- The Government should encourage search engine providers like Google to make sure that people can easily pick out debt advice services that are free and impartial (4.3).

1. INTRODUCTION

1.1 This is the formal response of the Consumer Credit Counselling Service (CCCS) to the Business, Innovation and Skills Committee Inquiry into Debt Management. CCCS would be happy to provide further clarification on any aspect of this response, and willing to give oral evidence to the Committee if required.

1.2 CCCS is the UK's leading debt charity. It speaks with authority as the UK's largest provider of independent debt advice, and the country's only major charitable provider of non-statutory debt management plans (DMPs), responsible for more than 30% of plans in the UK.

1.3 In 2010, CCCS helped over 400,000 people deal with their personal debt problems. In 2009 we helped half a million people, or nearly 2,000 people every day. The charity currently manages the repayment of almost £3.6 billion of unsecured debt. Our 800 full time staff deliver a unique telephone based service, providing high quality support to clients from ten centres in England, Scotland, Wales and Northern Ireland.

1.4 CCCS introduced DMPs to Britain in 1993 as a charitable response to a major social need. We remain the main provider, currently administering over 115,000 plans—estimated to be about one third of the total. Over the last 18 years, they have become an essential component of UK debt advice. The DMP enables those who can to repay their debt in a way that is cost-effective, flexible and fair to both the borrower and his creditors. For many, it provides a vital breathing space at a time of severe financial strain.

1.5 The charity's ethos is to help the "can't pays", not the "won't pays". We always aim to help clients pay back what they owe, in a realistic timescale and manner suited to their individual situation. The advice, counselling and repayment plans that we provide are always:

- Free for the client.
- In the best interest of the client.
- Independent and impartial.

1.6 CCCS is funded by all the major banks, credit card companies and other lenders, and receives no public monies. Creditors agree to pay what's known as a "Fair Share Contribution" in recognition of the unique service CCCS provides to the financially vulnerable.

1.7 Fair Share funding means the creditor, rather than the debtor, pays for debt advice. The charity has repaid £1.5 billion to creditors since 1993. Only around 10% of the services we provide are eligible for Fair Share, but this is enough to enable CCCS to help the nine in ten people for whom a DMP is not best advice.

1.8 In contrast, the fee-charging model of DMP provision is based on up-front fees to the debtor for setting up a DMP and ongoing monthly fees for managing the plan. The free advice and support that CCCS provides means clients only pay what they owe and are able to repay their debts more quickly. The extra support we offer includes action for households facing bankruptcy or repossession and specialist help for vulnerable debtors, such as those with mental health problems, and the self-employed.

1.9 CCCS is geared to expand to help people as they need—the charity was able to rapidly step up its operation in response to the recession to meet a 35% increase in demand for its services.

2. DEBT MANAGEMENT: A DISTRESS PURCHASE

2.1 Individuals looking for a solution to their debts are essentially making a "distress purchase": People contacting debt management companies (DMCs) are often over-indebted, vulnerable and desperate for help to manage their financial difficulties. Consequently, many tend to make quick decisions about complex and often unfamiliar debt solutions and tend not to shop around.[17] There is almost no price sensitivity for debt management services and debtors generally go with the first company they find, regardless of their ability to provide appropriate advice.

[16] "Debt and Household Incomes", CCCS-commissioned report, July 2011 http://www.cccs.co.uk/Portals/0/Documents/media/reports/additionalreports/Report_Debt_and_household_incomes.pdf

[17] "Debt Management guidance compliance review", Office of Fair Trading, September 2010 http://www.oft.gov.uk/shared_oft/business_leaflets/credit_licences/OFT1274.pdf

2.2 Debt seldom comes in isolation, rather it is associated with other, often traumatic, life events such as illness, divorce or unemployment. CCCS research shows that as people become more indebted, their openness to advertising rises and their readiness to speak to creditors falls. Households in financial distress find it difficult to see why any one of their creditors should help when they have debts to multiple different lenders.

3. The Importance of Free Advice

3.1 CCCS welcomes the Government's intention to ensure greater public awareness of impartial free debt advice sources [Summary of responses, 5.38]. People in financial difficulty need to "have access to the appropriate debt advice and assistance that they need, at the time they need it".

3.2 While lender signposting and referral is the most effective[18] means of encouraging debtors to seek early support, much stronger action is required to ensure that the wider public know the options available to them and get the most appropriate and sustainable solution(s) for their circumstances.

3.3 We believe the promotion of free debt services should be a key activity of the newly created Money Advice Service (MAS), which is responsible for coordinating debt advice to better serve those in financial difficulty.

3.4 CCCS is in ongoing discussions with MAS: we are keen to see a more efficient mix of delivery channels (online, telephone and face-to-face), better partnership working and greater promotion of the free sector as the best place to go for financial recovery. A key benefit of the holistic service CCCS provides is that clients pay less and are able to repay their debts more quickly (cf 5.3 and Appendix A).

The need for greater partnership working

3.5 CCCS has the capacity to help many more people by telephone or online. Our unique online debt counselling service, Debt Remedy, now delivers the most appropriate solution to almost half our clients, and effectively has limitless potential. Not only are the cost implications of moving to other channels significant (average cost of a face-to-face session is £265; telephone £51; online £3),[19] it is increasingly what people prefer. The cost savings CCCS has made has enabled the charity to develop new partnerships to help more people struggling with unmanageable debt.

3.6 CCCS has recently started a strategic partnership with Citizens Advice. The partnership enables clients of 80 participating bureaux to benefit from our unrivalled systems of help and support when making repayments to creditors through a DMP. It means bureaux get a share of the monies CCCS receives from lenders, while staff are freed to concentrate on more vulnerable people who need extended support. Our longstanding partnerships with the Money Advice Trust (National Debtline) and the Limavady Community Development Initiative have provided an important source of sustainable funding for these two organisations.

3.7 The CCCS-Citizens Advice strategic partnership aims to increase capacity in the free sector while raising awareness of CCCS so we can help more people. It demonstrates how two agencies working together can direct people to the most appropriate advice for them, ensuring that the most expensive form of delivery—face-to-face advice—is kept for the people who need it most—the most vulnerable. No-one should have to turn to the fee charging debt management sector for lack of available free advice.

4. The Problem With Commercial Debt Firms: Misleading Advertising

4.1 Too many households are poorly served by the current debt landscape. In its 2010 probe of commercial debt firms, the OFT identifies misleading advertising as "the most significant area of noncompliance" with its guidance.[20] The review highlights that many firms continue to claim their services are free when they are not.

4.2 People in debt trouble need better protection, in particular from the often relentless advertising from DMCs on daytime television. Regulators need to ensure that breaches of the rules are met with a tough response. CCCS believes that firms should be obliged to state the level of fees under a smarter, more transparent advertising regime. At the same time, DMCs should be required to inform potential clients of the availability of free services.

4.3 People now look to Google as the first port of call for information on how to solve their debt problems. However, its method of selling adverts for keyword searches continues to give firms with big advertising budgets a significant advantage over charities like Citizens Advice and CCCS. The unwarranted visibility of commercial firms is clearly a problem—the last thing you want when you are looking for "free debt help" is to be directed to a choice of fee chargers. The Government should encourage search engine providers to make sure that debtors can easily pick out those services that are free and impartial.

[18] Around 60% of referrals to CCCS's helpline were from creditors in 2010, with relatives and friends the next biggest source.

[19] "Helping Over-indebted Consumers", National Audit Office, p6
http://www.nao.org.uk//idoc.ashx?docId=12b77c4c-2069–4242–8d5e-e1fcb9797d96&version=-1

[20] "Debt Management guidance compliance review", Office of Fair Trading, September 2010, p7.

5. The Problem With Commercial Debt Firms: The Scale of Consumer Detriment

5.1 The Office of Fair Trading (OFT) estimates that DMCs make £250 million every year from already over-indebted clients.[21] This constitutes the most significant detriment debtors face when free options like CCCS are readily available.

5.2 Three quarters of commercial debt firms front-load their charges.[22] Customers pay several hundred pounds before receiving any advice, equivalent to two months of repayments. On top of this, monthly administration fees are typically about 17% of the debtor's repayments.[23] This pricing structure guarantees quick profits for firms and reduces the capacity of borrowers to pay back their debts.

5.3 Clients of fee chargers pay more and it takes longer to pay down their debts. For example, for a debt of £30,000,[24] a client of a typical debt management company would pay almost £6,000 extra in fees (over and above loan repayments). This would extend the plan by approximately 18 months compared with a CCCS DMP, which is free (see Appendix A).

5.4 However, in practice, few DMPs run for their full term. This accentuates the impact of fees and increases the proportion of client payments absorbed by them (and hence the cash flow benefit to the DMC of upfront payment).

A ban on upfront fees

5.5 Upfront fees support a business model which has pernicious consequences for people in financial distress. There is an urgent need for government and regulators to work together to ban upfront fees in the debt management sector. The Government should also look at the case for capping monthly fees in the sector.

6. Regulation, Enforcement and the Need for Tougher Licensing

6.1 The OFT requires all DMP operators to provide advice in the best interests of consumers. However, its 2010 inquiry into the debt management industry found that in general, firms provide consumers with "very poor" advice.[25] Of the OFT's 148 visits to debt management firms, just 12 complied with OFT guidelines and the Consumer Credit Act.

6.2 Many operators have for too long simply ignored the regulator's minimum standards for fair practice as set out in its debt management guidance. Sixty-one firms have faced licensing action by the OFT since its 2010 review, but stronger licensing and enforcement measures are required.

6.3 DMCs operate in what the OFT deems a "high risk area" for vulnerable consumers, who suffer significant and long term damage when things go wrong. Under section 25 of the Consumer Credit Act 1974, the OFT has a duty to ensure that only those who are fit and competent are given and retain a licence. There is an ongoing duty to monitor licencees' fitness throughout the life of the licence.

6.4 New provisions introduced by the Consumer Credit Act 2006 give the OFT more direction over how to assess the fitness of firms to hold a consumer credit licence.[26] The regulator's proposed revisions to its debt management guidance[27] take this further, but stronger enforcement is required—while there has been some progress recently, just 14 consumer credit licences were revoked in the five years up to 2010.[28]

6.5 CCCS believes the OFT needs to be better resourced to properly enforce its existing guidance. This should be linked to the urgent need for more rigorous audit and compliance. We propose that DMCs who want a licence under Category D (Debt Adjusting) or Category E (Debt Counselling) should be subject to both annual application and annual audit by the OFT (or approved auditors). An uplift of the minimally low licence fee[29] to circa £20,000 would cover the cost of an improved regime for firms operating in these areas.

7. Providing the Best Solution and Improving Standards of Advice

7.1 People enquiring about DMPs to a fee charging debt company are often not presented with the various debt and insolvency options available to them (OFT, Paragraph 5.8, p35). The OFT has found that:

[21] *ibid*, p4.
[22] *ibid*, p9.
[23] "An Independent Review of the fee-charging debt management industry", Sharon Collard, Personal Finance Research Centre, University of Bristol, June 2009
http://www.infohub.moneyadvicetrust.org/content_files/files/mat_report_final_v4.pdf
[24] The average debt for a CCCS client is around £24,000. A client of a typical fee charger would pay £4,235 extra in fees over the repayment term and take 18 months longer than with CCCS.
[25] OFT, p9.
[26] "Debt Management Guidance", OFT, paragraph 1.10, p4
http://www.oft.gov.uk/shared_oft/business_leaflets/credit_licences/oft366.pdf
[27] "Debt management (and credit repair services) guidance—a consultation", OFT, June 2011
http://www.oft.gov.uk/shared_oft/consultations/OFT1338con.pdf
[28] Hansard, HC Deb, 3 February 2011, c955W
http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110203/text/110203w0004.htm#11020337005064
[29] "Fees, refunds and payments for credit licences", OFT. Available at
http://www.oft.gov.uk/OFTwork/credit-licensing/fees-refunds-payments/

> "DMCs are not giving the advice or offering the solution that is in the best interests of the consumer, but instead that which is most profitable to them."[30]

7.2 The advice provided by fee charging companies is skewed towards DMPs and Individual Voluntary Arrangements (IVAs), which support a revenue stream for the firm. As a result, large numbers of debtors end up with the wrong solution [Summary of responses, 5.9].

7.3 For instance, only one commercial debt management company provides Debt Relief Orders (DROs),[31] which are a key insolvency tool to help people with few assets and low incomes.

Meanwhile, debtors who cannot support a fee-paying plan are directed to free services like CCCS or Citizens Advice. Provisions in the codes of conduct for the two main trade bodies (DEMSA and the DRF) can be read as directing unprofitable debtors to the charitable sector (see Appendix B).

Both of these examples show that DMCs are not concerned to act in people's best interests if it costs them money or hits their bottom line.

7.4 However, CCCS is also concerned that the business model for commercial debt firms relies on cherry picking behaviour. A staggering 80% of borrowers entering an IVA have already been through other debt management arrangements.[32] Inevitably there is some movement between debt solutions—for example, some CCCS clients do not stick to their DMPs for the full term, either because they enter self administration or can no longer repay. However there is little doubt that the ability of DMCs to charge a new round of fees for setting up a second plan contributes to the high incidence of so-called "flipping".

7.5 Some fee charging DMCs are looking at ways to improve their funding model. However, while superficially attractive, extending the CCCS fair share funding model to the fee chargers puts at risk the full range of debt solutions that clients need.

7.6 For profit companies would continue to target their advice to debt solutions that improve their balance sheet—while charities like CCCS who serve all debtors will be put at risk. Only one in ten people who contact CCCS goes onto a debt management plan, other clients receive welfare benefit checks, token payments or debt solutions like DROs, none of which forms the basis of the funding we receive. We know that cherry-picking already goes on, but moving to this model would incentivise the behaviour on an industrial scale as it would be necessary for funding and vital for market position. Instead of building on what works, any new developments in this area could reduce the solutions available to clients and detract from the holistic service many of us are trying to provide.

7.7 CCCS agrees with the Government that not enough is known about the industry [Summary of responses, 5.44]. DMCs should be much more transparent. The charity publishes an annual yearbook including information on the number and types of debt solution recommended to clients, the number of DMPs setup, and the average payments made by clients on DMPs.[33] A requirement for commercial firms to publish this type of data would demonstrate the impact and extent of cherry picking behaviour. Further, the Insolvency Service should publish breakage rates for IVAs to show if they are being offered inappropriately.

7.8 Pledges made by DEMSA and the DRF to improve standards among their members have to be seen in light of the "very poor" standards[34] that are the norm among for-profit providers. Training cannot be piecemeal—the OFT's exposure of the breadth of shoddy advice reinforces the need for a national qualification that enables people to see that a consistent set of standards are being met. This should be based on the Ofqual accredited diploma in money and debt advice that staff at CCCS undertake, a year-long course that offers the most specific, relevant training for debt advisers.

7.9 While the OFT's work to drive up standards among the largest DMCs is welcome, CCCS is concerned about the regulator lending its credibility to members of the main trade bodies through its Consumer Codes Approval Scheme.

A recent case illustrates one of our key concerns: In November 2011, DEMSA imposed sanctions on a member for masquerading as a free advice provider[35]—however, the trade body refuses to say which firm broke its rules, acting in the interests of its member, not the consumer. Meanwhile, "Member X" continues to brand itself with the OFT-approved code logo, with consumers none the wiser.

Perversely, a charity like CCCS cannot sign up to an OFT-approved code, and therefore cannot brand itself with the OFT logo.

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30 "Debt Management guidance compliance review", OFT, p9.
31 The Insolvency Service lists details of competent authorities for DROs: http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/bankruptcy/DRO/auth.htm
32 "Reasons to avoid debt management firms", Which? http://www.which.co.uk/money/credit-cards-and-loans/guides/how-to-deal-with-debt/reasons-to-avoid-debt-management-firms/
33 CCCS Statistical Yearbook 2010, CCCS http://www.cccs.co.uk/Portals/0/Documents/media/reports/statisticsyearbooks/stats-yearbook-2010.pdf
34 "Debt Management guidance compliance review", OFT, p9.
35 "DEMSA imposes sanctions on member", Credit Today, 8 November 2011 http://www.credittoday.co.uk/article/11208/online-news/demsa-imposes-sanctions-on-member

8. Statutory Repayment Plans and the DMP Protocol

8.1 The Government has proposed a DMP Protocol setting out what all parties can expect from a DMP. The hope is this will ensure that debtors are treated more consistently, both by creditors and by fee-charging DMP providers.

Cross-industry meetings are taking place, with CCCS arguing that both creditors and debt management companies should agree to meet a set of stringent obligations. This includes creditors signing up to token payments solutions (see section 9, below).

8.2 However, in the absence of a sufficiently strong commitment to the Protocol from DMP providers, who continue to deliver unfair outcomes for clients, the introduction of a statutory plan may become necessary. Our strong view is that this needs to be limited to authorised not-for-profit operators, as the TCE Act 2007 provides [Summary of responses, 5.39].

9. A Breathing Space Solution

9.1 The most pressing problem for about 30% of the clients counselled by CCCS is that there is no immediate answer to their debt problems—none of the existing solutions is appropriate. However, in many cases, for example where there is a serious reduction in income caused by redundancy, the client has good reason to believe that their situation will sooner or later improve.

9.2 To help these clients, CCCS in 2010 piloted a scheme to see if the opportunity to make "token" payments to lenders for six months would buy the time they needed to sort out their affairs. The scheme was a success, proving an important stop-gap measure: in almost all instances, lenders stopped adding interest and charges or contacting clients—in effect, introducing a non-statutory moratorium [Summary of responses, 5.48] for clients on a CCCS token payments solution.

CCCS expects to roll out a full token payments scheme—with regular reviews and longer term plans—by the second half of 2012. We want creditors signing up to the DMP Protocol to commit to accepting token payments, provided appropriate safeguards are in place.

9.3 Our experience with token payments underlines the need to consider on a wider scale how this most vulnerable client group can best be helped. It may be useful to look at remedies available in other countries, for example the French "retablissement personnel" aimed at debtors for whom even partial repayment is not possible.

APPENDIX A

Repayment of £30,000 at £300 per month under a DMP

	Fee-charging debt management company	*CCCS*
Client debt	£30,000	£30,000
Monthly repayment	£300	£300
Upfront fees	£600	-
Monthly fees	£45	-
Term of DMP	9 years, 9–10 months (117–118 months)	8 years, 4 months (100 months)
Total repaid (including fees)	£35,894	£30,000

Notes:

1. Fee charging company assumed to charge start-up fee equivalent to two months' payments and ongoing monthly fee equivalent to 15% of payments.

2. Term assumes full repayment of £30,000 loan principal based on total monthly payment (including any fees) of £300 per month.

3. Term assumes monthly fees deducted. Allowing for up-front fees of two months' gross payments adds a further two months to the DMP term for the fee-charging company.

APPENDIX B

TRADE BODY CODES

According to Clause 13 of the DEMSA code on Client Interests: "Members must demonstrate that they act solely in their clients' best interests. In doing so they must help clients to clear their debts as quickly and efficiently as possible, and must not use high pressure selling tactics." However, Clause 17 on Extreme Hardship Cases states: "Where it appears that applicants are unable to pay any management fees due to the severity of their financial position, members should, where appropriate recommend such clients to non profit advice centres."

Similarly, Section B of the DRF code states: "DRF members approach debt resolution on the basis of identifying the solution and the outcome which is most compatible with the financial and personal position of the debtor, while taking into account the interests of the creditors of the debtor and demonstrating to them that the proposal made on behalf of the debtor is reasonable in the circumstances and is achievable." However, Clause 8 of Section D on Debtor vulnerability states: "DRF members support debtors where appropriate and possible, recognising the vulnerability of many debtors. DRF members refer cases where none of the debt resolution solutions appear to be suitable in the debtor's circumstances to suitable alternative agencies (eg in the not for profit sector)."

These clauses appear to be an admission that the main interest of DRF and DEMSA members is in clients capable of sustaining a DMP or IVA (and therefore provide them with an income stream), with the charitable sector expected to handle all other clients.

14 November 2011

Supplementary written evidence submitted by Consumer Credit Counselling Service

CCCS and "Fair Share" Funding

The session on Tuesday covered a range of issues but did not have time to discuss the CCCS fair share contribution (FSC) funding model. This note, therefore, sets out how the arrangement works and how it helps to ensure—through voluntary arrangements with the creditor community—we are able to provide free, impartial and high quality debt advice to people as they need.

CCCS helped over 400,000 people deal with their personal debt problems last year. Since its founding in 1993, a key principle of CCCS is that private monies from the financial services industry should fund the charity to help and support the over-indebted. During the CCCS's formative years, much time and effort was spent by the chairman and trustees in achieving the support of lenders. Subsequently a sustainable revenue stream in the form of a FSC from their collections and recoveries functions was agreed.

Today, virtually all the major banks, credit card companies and other lenders agree to pay FSCs in recognition of the unique service CCCS provides to the financially vulnerable. The payment is based on creditors returning a percentage of the monies repaid to them through Debt Management Plans (DMPs). For clients, every penny paid goes to pay off their debts, while lenders donate separately to CCCS. This enables CCCS to operate a free and impartial service that provides help and support for all.

It is important to appreciate that lender support for CCCS is based on *voluntary donations* that nonetheless provide us with a sustainable revenue stream. Market research shows that borrowers in heavier debt are more reluctant to speak to their creditors and do not want to pay for help. Creditors appreciate that the independent, high quality and holistic service CCCS provides means clients are better placed to repay their debts over time (through DMPs). To this end, CCCS disbursed £289 million of client monies to creditors in 2010, while the charity's income from FSCs was £28.6 million (90% of operating income).

Technological developments in the form of our unique online debt counselling service, Debt Remedy, and the application of its rules-based approach to our telephone helplines meant that as the recession hit, CCCS was able to rapidly step up its operation to meet a 35% increase in demand for its services, doing more for less. While only one in 10 of the services we provide are eligible for Fair Share, this is enough to ensure CCCS can provide impartial support to the nine in 10 people who contact us who do not end up on a repayment plan.

However, the success of the charity's "fair share" arrangement has prompted some in the commercial sector to look to at how they can improve their funding models.

One for-profit debt management firm, Payplan, is funded by similar—but contractual—agreements with creditors, enabling it to offer free-to-client DMPs. However, Payplan is a company and therefore has to look after its bottom line when deciding who it provides services to. To support its model, Payplan, like the other for-profits, engages in selective behaviour—the company only provides a service to debtors who can find at least £50 disposable income in their monthly budgets—other people struggling with unmanageable debt will need to look elsewhere for help. By contrast, CCCS has a token payments scheme that we will be rolling out in full in 2012 to give debtors experiencing a temporary income shock an extra breathing space (9.1–9.2).

The further expansion of this type of funding arrangement therefore presents a serious threat to the very benefit that "fair share" provides to the UK's wider debt advice needs. Although it might seem superficially attractive to extend fair share funding to the fee chargers, the danger is it puts at risk the full range of debt solutions that clients need.

The main risk is that for-profit companies would continue to target advice at the debt solutions that are most profitable to them (see points 7.1 and 7.2 of our submission)—while charities like CCCS who serve all debtors would be put in jeopardy (7.6).

In our submission to the inquiry, we showed there is strong evidence that for-profit debt management firms cherry-pick who to help, based on whether or not clients provide them with a revenue stream (7.3–7.4). That firms offer profit-seeking, rather than the most appropriate advice, is a key finding of a recent review of the sector by the Office of Fair Trading (7.1). Therefore, the danger of opening up fair share to commercial firms is that it would incentivise this behaviour on an industrial scale, becoming all the more necessary for revenues and absolutely vital for market position. Instead of building on what works, expanding fair share to the for-profits would *reduce* the solutions available to clients and *detract* from the holistic service that those of us in the charitable sector are trying to provide.

In contrast, the CCCS approach is to develop a strategy for "fair share" that increases capacity in the free sector and ensures key charitable partners have access to sustainable private sector funding. Our longstanding partnership with the Money Advice Trust (National Debtline) is one example, yielding £815,000 in 2010 for the Trust's impartial free-to-client advice service.

Meanwhile, our new strategic partnership with Citizens Advice means that local bureaux get a share of the monies CCCS receives from lenders when they refer clients to CCCS-administered DMPs (3.6–3.7).

Innovative arrangements like these are essential to help struggling borrowers sort themselves out. The scale of personal debt and its impact on people's lives demands a strategic response and the free sector remains the best place to go for financial recovery, hence CCCS continues to be the largest and most respected provider. The free sector needs to be protected and promoted as such, with partnerships and a more efficient mix of delivery channels ensuring people get the independent, impartial debt help that they need.

25 November 2011

Written evidence submitted by Consumer Focus

About Consumer Focus

Consumer Focus is the statutory consumer champion for England, Wales, Scotland and (for postal consumers) Northern Ireland.

We operate across the whole of the economy, persuading businesses, public services and policy makers to put consumers at the heart of what they do.

Consumer Focus tackles the issues that matter to consumers, and aims to give people a stronger voice. We don't just draw attention to problems—we work with consumers and with a range of organisations to champion creative solutions that make a difference to consumers' lives.

We welcome this Committee's inquiry into these issues. The Government's response to the consultation on managing debt and personal insolvency is long overdue.

The consultation paper itself was poorly formulated, asking wide ranging and unfocused questions making it challenging to understand the thinking behind the proposals on deregulation for example.

Since the closure of the consultation in December 2010 the detriment experienced by consumers in this market has worsened—with higher rates of indebtedness, insolvency and repossessions.[36] In contrast, the high cost credit market appears in rude health.

Competition in the market is high yet this competition has neither driven down prices nor eliminated some truly shocking bad practice. Indeed, annual percentage rates (APRs) have risen, as has consumers' reliance on high cost debt to make ends meet.

In our response we highlight our key concerns with the market. A copy of our full response to the BIS consultation is available on our website;[37] however we wish to focus on high cost credit, credit scoring and the commitment to end unfair bank and financial transaction charges.

High Cost Credit

Improving the provision of affordable credit is vital to solving detriment in this area. We recognise that third sector providers such as credit unions and community-based finance initiatives have an important role to play, but they are still marginal providers and would need substantial investment to have the capacity to meet the demand.

It is mainstream financial services providers that currently have the scale and reach to provide access to affordable credit. We have recently published research into this issue *Affordable Credit—Lessons from overseas.*[38] For this research we asked the Personal Finance Research Centre to examine options for making better provision of affordable credit for those on low incomes, especially drawing on experience in other countries. The research found greater willingness from mainstream financial institutions in other countries to

[36] http://bit.ly/sL4MlN
[37] http://bit.ly/ewlBmw
[38] http://bit.ly/px5qS5

provide lending to low income consumers. The findings provide food for thought in terms of lessons for the UK. The Committee may wish to examine this research.

The debate around high cost credit continues to centre on the hotly-contested issue of interest rate caps and the potential consequences. We welcome the Government announcement that it will commission research on this topic. Yet, beyond that debate we need a wider discussion about what responsibility mainstream lenders have to provide affordable, safe and trustworthy credit products to low income consumers.

In terms of the current provision, there is undoubtedly a need to improve practice within this area. With regard to payday loans, the consumers in our study found that the rigour of the application process varied between lenders. Some of the borrowers felt that their lender would lend to "almost anyone".[39]

We have significant concerns that Payday Loans providers are not complying with obligations around responsible lending, most notably on affordability checks and ensuring loans do not "rollover" causing an unbearable burden on consumers in financial difficulty.

To protect borrowers we suggest:

- limiting the number of rollovers or repeat loans to five per household per year by clarifying the Office of Fair Trading (OFT) irresponsible lending guidance;
- effective affordability checks (for first and additional loans);
- limiting loan values by income (for first and additional loans); and
- information sharing between lenders to prevent multiple loans.

Following publication of our report *Keeping the Plates Spinning*,[40] the industry established a forum to draw up a Code of Practice. A Lending Code for Small Cash Advances was drawn up and the Consumer Finance Association launched it in July 2011. While the Code made some progress that will be helpful for consumers, it did not address key issues for the protection of vulnerable consumers which our research had identified.

Research by Which? and Citizen's Advice has found evidence of widespread problems in this market and we welcome the announcement by the Minister Ed Davey of a compliance review in this area. However while compliance with existing regulation is a key concern, the rules do not address the key problems.

The willingness of industry to work on self regulation is strong but it is doubtful that the measures we would like to see put in place will be achieved by any voluntary Code. We consider that consumers are only likely to get the full level of protection they need from regulatory measures to both limit the number of loans/rollovers and to oblige the industry to undertake appropriate credit checking activities.

Lord Turner, Chair of the Financial Services Authority (FSA) has suggested that competition-based solutions, although a critical component of any healthy financial system, may be "less powerful in financial services than has been conventionally assumed".

According to Lord Turner: "if both policymakers and existing markets are imperfect, the appropriate response might seem to be to concentrate policy initiatives on making markets more competitive. It is unclear, however, that this will be as powerful a lever as often supposed. In retail financial services it is, for instance, notable that some of our greatest concerns about high distribution margins and inappropriate advice have arisen in activities characterised by huge numbers of competitive firms".

That is to say, competition should be seen in terms of the plurality of approaches and providers: it should not be assessed, and is unlikely to deliver significant consumer benefits, if it simply means an increased proliferation of market entrants operating according to a conventional and broadly similar banking model.

These words must be heeded in relation to the high cost credit market.

Credit Scoring and its Impact on Consumers

Consumer Focus calls for greater transparency around credit scoring. Credit reference agencies' (CRAs) power to analyse consumers' wider data in determining credit worthiness has grown beyond the value that their analysis provides in ensuring responsible lending.

Firstly, checks by lenders on borrowers should primarily be about affordability, not credit scoring. Affordability is about the impact of the loan on the borrower's "overall financial well-being".[41] This assessment should look at the following variables:

- Lenders to be required to obtain evidence on the consumer's income and expenditure to show they could repay the loan at the current rate and under a stress test scenario.
- Whether the consumer has any other loans, or liabilities.
- Any county court order, defaults or insolvency records.
- Finally, a more thorough analysis of a consumers credit behaviour.

[39] Keeping the plates spinning: Perceptions of payday loans in Great Britain, Consumer Focus, August 2010.
[40] http://bit.ly/n5dL6K
[41] http://consumerfocus.org.uk/g/4m5 P7

The first three only require the provision of the most basic information by CRAs. The fourth one, in essence, is trying to understand the consumer and their attitude towards borrowing and repayment, beyond credit defaults.

It is only when a consumer has no, or a limited, track record with that bank that additional data and analysis by the CRA is justified. Any assessment by the CRA, or indeed the lender, should not be given undue emphasis when put alongside the other three variables that detail both affordability and attitude towards repayment.

Consumer Focus understands that credit reference information is already accessed and used by utility companies to varying degrees. Our recent report on data sharing in energy shows there are concerns about the potential for errors and misuse of data.[42] Energy suppliers already hold substantial information about their customers and it is imperative that this data is used responsibly.

It is essential that any new data sharing from other institutions is sufficiently robust to be fair to consumers. They must make sure any data shared on consumers is up-to-date, accurate and any debts outstanding are not disputed by the consumer.

There is growing concern that consumers with a "low credit score" may come under increasing pressure from suppliers to sign up to prepay tariffs. Furthermore, there may be moves by suppliers to introduce differential pricing policies for credit customers, influenced by their credit history. These two issues may become increasing important ahead of the roll out of smart meters and the introduction of the Green Deal.

Additionally, we are eager to understand whether the widespread use of credit referencing data could have an impact on the level of competition and choice offered to consumers with poor credit reference histories.

Another area of concern for consumers is how credit scores are determined, CRAs analysis and scoring criteria has public policy consequences and can cause significant consumer detriment. There is little evidence that CRAs' analysis is more accurate at predicting defaults than affordability assessments.

Defaults are mostly the result of unexpected economic shocks to consumers—either personal or due to wider economic conditions and therefore CRA scores do not predict such future behaviour.[43]

Consumer Focus believes that the criteria that informs credit worthiness assessments needs to be subject to oversight. The collection and analysis of an array of data needs to be democratically legitimised and consulted on with society more widely. There are huge consequences for consumers that need to be considered and weighed against other public policy goals.

There are wider issues around data sharing that are beyond the scope of the Information Commissioners' Office's (ICOs) powers. Currently, the only forum to discuss data sharing practices is the Steering Committee on Reciprocity. This has a poor track record on consumer representation and engagement. We believe the following examples prove greater engagement is needed to ensure the public policy implications of data sharing are fully explored.

Switching current accounts

Consumer Focus investigated switching in the personal current account (PCA) market to look at whether it was likely to influence competition among banks and affect unfair charges. Our research shows that 11% of those who had thought about switching current accounts decided not to, due to fears about the effects on their personal credit rating.

The fears are predictably strong for younger consumers who rely on a good credit score in order to obtain mortgage credit. Following investigations with the CRAs we have been informed that this is not a criteria used in all credit scoring. However, we are unable to confirm this categorically as the CRAs do not reveal their methodology for credit scoring. We recommend the committee investigate this matter further.

Multiple loan searches

Similarly shopping around for loans can have an impact on credit ratings. Yet many products are *rate-for-risk*, so without applying you cannot know the rate. Consumer Focus wrote to the "*standing committee on reciprocity*" to make clear our concerns.[44]

Consumers need to have the guarantee that sharing more of their data does not mean they are scored down because they search for the best deal. Moving to quotation searches, which do not leave a footprint, as a default across the industry rather than as a rarely exercised option is an obvious solution. It would appear some firms such as Nationwide offer such credit products that complete "soft" checks that do not leave a mark on the credit file. Yet, our understanding is that credit checks for other cards do not offer that method of credit scoring, and so discourage "shopping around" for the best deal.

[42] http://bit.ly/tgKmlB
[43] http://bit.ly/rtn8A0,page v
[44] Alongside Money Saving Expert see http://bit.ly/e9l2er

Consumers ability to see, understand and challenge the data (or analysis) on their credit worthiness and consumer control about the sharing of data

Consumers are not given sufficient control over the sharing of their information, nor to the uses to which such information will be put. Under the current Lending Code guidance if the customer does not give permission to share information about the day-to-day running of their account, there are 11 other ways of permission being implied on the basis of the Information Commissioner's guidance, including through the terms and conditions in an opening pack. That is not sufficient protection or choice from the consumer's perspective and it needs amending. Permission must be sought in relation to each disclosure and how that data will be used.

Commitment to End Unfair Bank and Financial Transaction Charges

We strongly supported this coalition pledge set out in the Programme for Government document. However from recent announcements in the Lords it seems likely that the Government is looking for industry led concessions with regulation and legislation put on hold. We withhold judgement while we wait to see the Government's proposals.

What the evidence does show is that it is highly unlikely that the OFT-led reform programme is capable of eliminating the evident detriment caused to some of the poorest and most vulnerable consumers in the UK.

Further action is needed to remove these punitive charges which mean low income consumers pay more for banking services than other groups, effectively excluding them from the full benefits of transactional banking.

Background

Studies have found that becoming included in the banking system had psychological benefits, boosting self-esteem and building people's confidence as money managers.[45]

However, the 2008 Market Study and follow up report in 2009, as well as the Competition Commission's investigation into the Northern Ireland current account market provide ample evidence of the unfairness of unauthorised overdraft charges (UOCs). The Financial Inclusion Taskforce has found the poorest are £140 worse off when they get a bank account. Furthermore, our own research with low income consumers has found these charges discourage entrance into mainstream banking, including Basic Bank Accounts and creates mistrust in mainstream banking providers.

The banks still accrue around £2 billion in 2010 from UOCs, down from £2.7 billion in 2006.[46] Despite radical changes to the charging methodology, these charges still provide a substantial portion of the banks revenue from the current account market and will continue to do so. Indeed, there is the potential for these charges to increase as the recession bites. It is vital to once and for all address these charges.

OFT Action

OFT took legal action on UOCs to see whether it could assess bank charges for fairness when the charging structure was not transparent. The Supreme Court ruled on the test case on unauthorised overdraft charges in November 2009. It ruled that the fairness of these charges could not be challenged on the basis proposed.

While the Supreme Court decision did leave room for the OFT to take a different legal route it choose not to pursue the case. Without the legal route to judging the fairness of charges, the OFT has relied on voluntary action by the banks to ensure improved market competition eradicates consumer detriment, namely on transparency of charges and enhancing control.

In its March 2010 paper the OFT claimed that, in light of its efforts to improve the clarity of costs of current accounts, banks have lowered unpaid item charges since its original report in 2008, falling from £34 to £17 on average in three years.[47]

However, charges have shifted from unpaid item charges to a whole host of more complicated penalty charging structures. Such variables include: days beyond the limit per month; amount beyond the limit; payments when overdrawn; and percentage of transactions that bounce. Some banks now have monthly caps limiting some of the most punitive charges. Others still have moved to high daily amounts (Halifax—£5 a day) for any use of UOCs, while the likes of Lloyds bank now have an additional £5 charge for any use of overdraft facilities per month on top of specific charges.

Thus, there is a wide diversity of charges that may well have reduced the worst cases of unfair charges but also reapportioned the cost in potentially worse ways for many consumers.

The greater complexity makes it even harder for consumers to choose. We do however welcome the banks agreement to "*pre-notify all fees and charges*" and offer an annual summary of charges to consumers in 2011.

[45] Low-income families and household spending, Farrel and O'Connor, 2003.
[46] OFT, PCA Progress Update, March 2011, p13.
[47] http://bit.ly/dbIVcg

As well as endemic complexity, it is very difficult to fathom and compare the actual expense of different accounts, since that assessment is based on future behaviour consumers may not be able to predict. This prevents low income consumers' engagement with the market.[48]

Finally, the methods put in place to aid consumer comprehension of such charges have not been effective. The OFT notes in its September 2010 report that the scenario testing documents, aimed to enhance transparency of charges and enable switching are difficult to find on the banks' websites.[49] There is also the related issue of the quality of the information provided to consumers.

We have yet to see any evidence from the OFT, Consumer Direct or the banks about how many consumers have used the charging scenarios either on the web, phone or face-to-face to inform switching decisions and their views of its usefulness. We believe to assess whether the scenario testing is working there should be an evaluation with consumers.

While there are proposals from the Vickers report to improve this, with for example the MiData work stream to enhance the power of price comparison sites, this will take years to develop and its effectiveness is unproven. Furthermore, as the Independent Commission on Banking (ICB) paper notes, inertia is engrained in the system, with very few consumers having switched or even considering switching. More generally, the ICB reforms were aimed at the mainstream section of the PCA market that do not pay UOCs and little attention was directed at helping lower income consumers in its final report.

The current state of affairs is that charges are difficult to predict, so meaningful comparisons—based on future behaviour that you do not predict—are impossible. Determining value at the lower end of the market is so confusing consumers are not increasingly inclined to switch. Thus, transparency has not improved.

Control

We are aware that there are certain providers who have started to provide the possibility of "opt-out" or "opt-in" accounts. However, these have not performed in a way that resolves the issue of detriment from unfair charges, and nor has it placed the power back in the hands of consumers.

Barclays have produced an "opt-in" account. Its charges, as part of the "*Personal Reserve*" which is exempt from a UOC facility, do marginally improve transparency since it is a single £22 charge for five days. Yet, it is unlikely to reduce the overall cost burden for consumers, when compared to its UOC charges. It would appear the Nationwide account reserve limit works on a similar basis. We are unaware of any meaningful means to opt-out of any charges associated with overdrafts apart from moving to a Basic Bank Account, which in turn still allows Unpaid Item Charges (HSBC exempted).

We are also aware of some movement on alerts, such as text messages to consumers showing them they are near their limit. These moves are welcome and we would welcome this facility being prescribed as a minimum standard moving forward.

The impact however, we believe to be limited. Consumers need to be offered a meaningful way to avoid charges, if their finances are in a difficult or unpredictable state. The current design of Direct Debits, with originators "pulling" funds, often with variable sums on differing days adds to the difficulty for consumers of managing their money to avoid such charges. No PCAs currently allow consumers this control to avoid charges and none are likely to moving forward.

Once again therefore, the OFT reforms have not been sufficient.

Impact of Reforms

The 2008 OFT report highlighted that "although over half of the interviewees had experienced insufficient funds charges, almost none had anticipated going overdrawn, having payments rejected, or paying bank charges. The conclusion of the psychological analysis was that some consumers are overconfident when it comes to their finances and probably underestimate the cost of banking".[50]

These empirical lessons from behavioural economics need to be reflected in the public policy debates. Consumers are poor at anticipating their use of UOCs, are overconfident and fail to engage with the market. Future policy moves to enhance switching (from the ICB) are unlikely to improve the market place for this section of the population.

Many of the transparency reforms have made pricing yet more complex and the scenario testing documents are unlikely to have aided many consumers to switch or predict charges. Finally, on control it is clear that text alerts are a welcome addition, but are insufficient to deal with the consumer detriment.

[48] *Stick or Twist*, p22.
[49] OFT, September 2010, p19.
[50] OFT, 2008, p70.

No accounts offer meaningful control to turn off UOCs and for those with minimal funds even a text is unlikely to aid them if a large Direct Debit has just been withdrawn from their account leaving them without sufficient funds.

14 November 2011

Written evidence submitted by Credit Action

Background

Credit Action is a national money education charity (registered Charity in England & Wales No. 1106941) established in 1994.

In January 2009 we also created our dedicated Welsh arm, Credit Action Cymru.

We offer a range of resources, tools and training to help everybody handle their money well, and to inform consumers so that they can make informed decisions about their personal finances.

Credit Action operates at a national level through advocacy, collaboration and partnerships with various groups and companies as well as at a local level through a variety of targeted projects, with a particular emphasis on those most vulnerable to financial difficulties and over-indebtedness. Through its work Credit Action reaches over 650,000 UK citizens every year.

We try and help as many people as possible avoid the pain of debt. However we recognise many contacting us will be in trouble already, so we work in partnership with the major debt counselling charity the Consumer Credit Counselling Service (Registered Charity No. 1016630).

Summary

- Credit Action welcomes the opportunity to contribute to the Business, Innovation and Skills Select Committee's inquiry on Debt Management. As an organisation with considerable experience of supporting consumers in dealing with debt, we take a keen interest in Government policy in this area, and originally responded to the Consumer Credit and Personal Insolvency Review in December 2010.
- Credit Action is pleased with certain aspects of the Government's Response on Personal Insolvency, which was provided in the July 2011 document entitled *Consumer Credit and Personal Insolvency Review: Summary of Responses on Consumer Credit and Formal Response on Personal Insolvency.* However, in our view there is still additional action that can be taken in order to provide further support to consumers.
- In particular, Credit Action believes that the success of any attempt to address consumer debt will be underpinned by the financial capability of consumers themselves, and that financial education therefore needs to be integrated into any debt strategy as systematically as possible. From the perspective of insolvency specifically, we feel that the debtor education courses which form a compulsory part of the bankruptcy discharge procedure in the United States provide a useful model. Our submission makes reference to various evaluation studies which have examined the effectiveness of such courses, and we believe that there is a strong case for implementing a similar scheme in the UK.
- We also recognise that it is vital to have a debt management sector that operates effectively and serves the interests of consumers. In our view, free debt advice providers are absolutely fundamental to this, and we hope that if the Money Advice Service takes on a co-ordinating role then it will execute this in a manner which offers appropriate support to such free providers.
- However, we also believe consumers in the debt management sector are in an almost uniquely vulnerable position, and that this has implications for the way in which the market operates. These are outlined in our submission, and we suggest that there are two areas in which some form of Government intervention may be warranted as a result. The first of these is in relation to advertising, and we urge Government to do as much as possible to enhance the visibility of free providers. The second concerns the potential for consumer detriment that is created by the presence of fee-charging companies, and we suggest that Government should look seriously at the possibility of introducing a cap on fees.

Introduction

1. Credit Action welcomes the opportunity to contribute to the inquiry on Debt Management being undertaken by the Business, Innovation and Skills Select Committee. Credit Action provides a range of educational programmes and guidance materials to help people to avoid falling into unmanageable debt, or to resolve their problems if they do. We also work closely with our sister charity the Consumer Credit Counselling Service, a leading provider of free debt advice. We therefore have considerable experience of the issues faced by those in debt, and an understanding of the landscape of the debt management sector.

2. Having originally submitted a response to the Review of Consumer Credit and Personal Insolvency in December 2010, we maintain a keen interest in the Government's proposals in this area. We are pleased by

certain aspects of the Government's Response on Personal Insolvency, such as the recognition that there is a need for greater public awareness of impartial free debt advice sources (paragraph 5.38). However, we also feel that additional action can be taken to further support consumers, which we outline in this submission.

3. In our view there are a number of key issues which, if addressed, would contribute to improved outcomes for consumers. Firstly, we believe that introducing some form of financial education element to both formal and informal debt resolution procedures, along the lines of debtor education courses that are a mandatory part of bankruptcy discharge in the United States, would enhance the rehabilitation process. Secondly, we feel that free debt advice agencies are at a significant competitive disadvantage compared to commercial fee-charging firms, particularly with regard to advertising which is especially important within the sector. Therefore, Government needs to be continually aware of the need to promote free agencies, and should view commitments made in the Response on Personal Insolvency as a beginning rather than a final settlement. Finally, we believe that the presence of commercial debt management companies in the sector can potentially cause significant consumer detriment, and that serious consideration should therefore be given to the introduction of a cap on fees in this market. We focus this submission on a discussion of these issues and the broader debates they touch on.

Debtor Education Courses

4. In our experience, financial education is crucial to enabling people to avoid the problems caused by unmanageable debt. If consumers have the financial capability necessary to handle their money effectively, utilise credit in a responsible manner, and deal with debt issues proactively, it is likely to reduce the chance that they will encounter serious financial difficulties. Whilst the Government's Response on Personal Insolvency does not focus significantly on financial education, in our view it is a key aspect of addressing the issue of consumer debt, as the success of any policy response will be fundamentally contingent on the financial capability of consumers themselves.

5. We therefore feel that the Government should seek to integrate financial education as systematically as possible into any strategy for supporting consumers in dealing with debt. Important steps have undoubtedly been taken in recent years with respect to consumer financial education, such as the establishment of the Money Advice Service, but we believe that more can still be done. Considering insolvency specifically, evidence suggests that this may be a moment when people are particularly receptive to changing their behaviour, and that providing appropriate education at this point has the potential to make a positive difference to the way they handle money going forward, thereby helping them to avoid similar problems in the future. The US model of debtor education courses is especially informative in this respect.

6. Financial education has been part of the insolvency process in the United States since 2005, when Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act. One of the provisions of this Act stipulates that anyone who files for Chapter 7 or Chapter 13 bankruptcy will be required to complete a two hour financial education course before their debts are discharged. This can be conducted face-to-face, by telephone, or online. There is a certain amount of evaluation evidence which attests to the effectiveness of these programmes, and we believe that there is a case for considering the implementation of a similar scheme in the UK as part of the rehabilitation process.

7. A number of studies have looked into the impact of debtor education. While it is admittedly difficult to assess this over the long-term as the policy is still a relatively recent one, the data that does exist suggests that in general this is a constructive process that participants feel has a positive effect. Some of the key findings are as follows:

- There is virtual unanimity amongst debtors in favour of the view that their ability to manage their finances improved as a result of undertaking a money education course. One study conducted for the US Department of Justice said that this applied to 97% of participants they questioned,[51] whilst another by the University of Illinois put this at 98.3%.[52]
- The University of Illinois also undertook a behavioural analysis as part of its research, and found that during the education process debtors were at a "teachable moment" when they would be open to new information and to changing existing behaviours.
- The US Department of Justice's evaluation stated that as a result of the education course, 44% of participants reported that they intended to adopt at least one financial practice that they had not planned to before, or that they planned to adopt a practice sooner than they expected. Three months later, 22% of participants reported that they had actually followed through on this.
- Research that was published in University of Iowa College of Law journal last year suggested that 33.3% of debtors said that the financial education course they received would have helped them avoid bankruptcy, and 72% said the course would help them avoid difficulties in the future.[53]

[51] US Department of Justice Executive Office for United States Trustees, "Report to Congress: Evaluation of Instructional Classes in Personal Financial Management for Consumer Bankruptcy Debtors", May 2008.

[52] Angela C Lyons, Tommye White, Shawn Howard, "The Effect of Bankruptcy Counseling [sic] and Education on Debtors' Financial Well-Being: Evidence from the Front Lines", May 2008.

[53] Deborah Thorne and Katherine M Porter, "Debtor's Assessments of Bankruptcy Financial Education", September 2010.

8. Some evaluation studies do point to areas in which the design of debtor education could be improved (for example, the aforementioned University of Iowa College of Law paper suggested that US courses needed to move away from a "one-size-fits-all" approach). However, the impression given by the research that we have encountered is that in general debtor education does have a constructive impact on participants.

9. We therefore believe there is a strong case for exploring ways in which a similar scheme could be implemented in a UK context, and that at the very least some form of preliminary pilot may be warranted. Indeed, Credit Action and the Consumer Credit Counselling Service would be prepared to participate in such a pilot if the Government were to seek partners. Whilst there would clearly need to be adjustments in the way such programmes operate to take account of the differences in insolvency and debt resolution procedures between the two countries, we feel that the core principle is one which could make a difference to debtors in the UK, and help reduce the risk that they will run into serious financial difficulties again. In particular, possessing core financial skills such as an ability to budget may be especially necessary for debtors going through a formal Individual Voluntary Arrangement or an informal Debt Management Plan, both of which require adherence to a set repayment plan over a prolonged period.

Issues within the Debt Management Sector

10. In addition to taking steps to support the financial capability of consumers, we also believe that it is vital for the Government to ensure that the debt management sector operates as effectively as possible, and that it serves the interests of those seeking help first and foremost. For us, free debt advice providers have an absolutely essential role to play in this. We note that the Government's Response on Personal Insolvency makes clear that its intention is to give the Money Advice Service a direct role in co-ordinating debt advice services (paragraphs 5.35—5.36). Should this be implemented, we hope that the Money Advice Service would provide appropriate levels of support to the vital work of free providers within the sector.

11. We are pleased by the fact that the Government's Response on Personal Insolvency recognises the importance of increasing the public awareness of impartial free debt advice sources (paragraph 5.38). However, this does highlight an important problem regarding advertising within the sector which, in our view, means that the playing field between commercial fee-charging companies and free providers is not a level one. Given that the former possess large advertising budgets that are simply unavailable to many free agencies, commercial firms are in a far stronger position to build brand recognition amongst consumers.

12. This is particularly significant within the debt management sector. In our experience, people who need help to deal with their debts are will often utilise the services of the first provider they encounter, rather than comparing between a range of agencies and selecting the one they deem most suitable (this has additional implications for consumers' ability to drive competition, which is something we consider below). Therefore, a company which has the resources to advertise widely is likely to achieve a larger market share simply by virtue of its enhanced visibility, regardless of the quality of the services it offers.

13. We understand that this situation is to some extent the result of commercial decisions made by individual companies, but in our opinion it is a major issue within the sector that has a tangible and significant impact on the way consumers behave. We note that the Government's Response on Personal Insolvency states that it believes "the work being done about debt advice" will ensure greater public awareness of free advice (paragraph 5.38). However, we would urge the Government not to consider this issue settled, to monitor developments carefully, and to take further action if necessary to deal with the disparity between commercial firms and free providers in this regard. Work currently being undertaken should therefore be seen as the beginning of this process, rather than its final resolution.

14. Beyond the specific issue of advertising, we also have broader concerns about the role of fee-charging companies within the sector, and would go as far as to suggest that their activities are a potential source of consumer detriment. As we have already suggested, we do not believe that consumers who seek debt advice perceive themselves as being in a market in the same way as when purchasing other goods and services. Their primary concern is often just to find help from somewhere, rather than to find help from the most cost-effective or appropriate provider for their specific circumstances. This makes them particularly vulnerable, and inhibits their ability to drive competition. We therefore feel that there is a case for additional intervention within the debt management sector through the introduction of a cap on the level of fees charged by commercial companies.

15. Given that free debt management solutions are available from certain providers, we see it as unnecessary for consumers to be placed in a position where they might have to pay excessive fees to a commercial company (the result of which could be to push them into arrears or to actually worsen their debt problem) for services which cost nothing elsewhere. Introducing a cap on fees is, in our view, crucial to preventing such situations from occurring.

16. We recognise that the Government's preference is to pursue non-regulatory routes wherever possible, as mentioned in the Government's Response on Personal Insolvency (for example, in paragraph 5.42 in relation to standards in the provision of Debt Management Plans). However, we would stress that consumers in the debt advice sector are in an almost uniquely vulnerable position, and that as a result this particular market does not operate in a conventional manner. Consequently, to ensure that the sector functions efficiently and that it

serves the interests of consumers primarily, Government intervention in the form of a cap may ultimately be necessary.

11 November 2011

Written evidence submitted by the Debt Managers Standards Association (DEMSA)

1. Introduction

1.1 The Debt Managers Standards Association (DEMSA) is a trade body representing 17 private sector debt management firms in the UK, which collectively represent 80% of the private sector debt solution providers. Its goal is to promote best practice and to protect the interests of their clients and the lenders to which they owe money. Member-firms have up to 20 years experience of helping people with their debt problems.

1.2 DEMSA agrees rogue operators exist and that they tarnish the entire sector. DEMSA is committed to working with the OFT and stakeholders to help address this and to raising standards.

The OFT, as industry regulator, has made some good progress, in revoking the licences of 65+ firms in the past year, as well as issuing undertakings and in updating its Debt Management Guidance. However, DEMSA strongly believes that the OFT enforcement powers are too restrictive and prevent them from swifter, and often, more appropriate enforcement action.

1.3 *Consumer awareness*

It is a requirement that all lenders must send any customer that goes into arrears a copy of the OFT's arrears Information Sheet (see Annex 1). They also have to send it to any customers they issue a Default Notice to. The Information Sheet details a comprehensive range of free-to-client providers. Brands such as the Citizens Advice Bureaux are amongst the most widely known, recognised and respected in the UK. Indeed in February 2010 the National Audit Office found a 97% awareness of the Citizens Advice Bureau amongst over-indebted people. Clients are therefore aware of these options and are making an informed choice to use a private provider.

1.4 *Choice*

Clients actively choose to manage their debts through DEMSA-member-firms because members offer:

- High quality, timely and easily accessible advice and on-going debt solution services.
- A holistic approach to the client's situation including appropriate advice and support on:
  - income maximisation;
  - budgeting;
  - priority lenders;
  - secured debt arrears; and
  - home repossession and assistance with legal action.

As well as renegotiation of unsecured debt repayments via the appropriate debt solution, many firms also provide budgeting support, access to banking facilities and money saving help.

- A high level of dedicated and personalised support and service throughout the life of their debt solution.
- The collection of a single payment and prompt distribution to their lenders.
- Education and empowerment to make informed choices.
- An intermediary between them and their lenders, negotiating affordable arrangements, ceasing lender contact or keeping it to a minimum.

1.5 There is no doubt that people with debt problems are at a vulnerable time in their lives and may be desperate to find a solution. Rogue operators can and do exploit this.

1.6 However, not everybody with a debt problem sees themselves as being in need of charity. Many are working professionals who have good financial awareness but have over-committed themselves or suffered a temporary change in circumstances or a life change event. They make an informed choice to pay a fee for a professional service that provides them with value for money.

1.7 No debt advice is "free". Either taxpayers, lenders or clients are funding it. DEMSA believes that free-to-client debt advice is fundamentally important for the most vulnerable of individuals and wholly supports the vital role of the Citizens Advice Bureaux (CAB) and all other similar debt advice agencies. Indeed some DEMSA members provide assistance and financial support to their local CAB.

1.8 As we have seen with recent changes to Legal Aid funding, free-to-client services must be focused on those most in need. In fact Legal Aid is no longer available as a matter of course for those with debt problems. A good analogy is the National Health Service. It is provided to all and is free at the point of use. However, some consumers choose to use private providers (usually for the choice and speed they afford)—choosing to pay for a service that they clearly value.

1.9 DEMSA sees the service its members provide as being complementary to those services offered through the likes of the CAB. As such DEMSA is already working hard to build partnerships with free-to-client providers and other key stakeholders. Every provider, however funded, has a duty of care to its clients and should be held accountable for the advice it gives and the services provided.

2. Background to DEMSA

2.1 DEMSA was founded in 2000 and now has 17 member-firms employing over 2,000 staff.

Although DEMSA itself covers only the activities of firms offering Debt Management Plans (DMPs), Individual Voluntary Arrangements (IVAs) and self-managed plans—many firms offer advice and access to the full spectrum of debt solutions—including bankruptcy, Administration Orders, Debt Relief Orders, and in Scotland, Debt Arrangement Schemes, Trust Deeds and LILA.

2.2 Debt Management / IVA market size and structure:

Estimated total DMPs in the UK	500,000
Estimated total DMPs managed for clients by private sector	250,000
Total number of DMPs managed by DEMSA members	205,000 (ie 41% of all DMPs are run by DEMSA members, 80% of all private DMPs)
Estimated total IVAs in the UK	155,000
Total number of IVAs managed by DEMSA members	52,000
Total number of individual debts being repaid by clients of DEMSA members	1,800,000
Total amount of debt managed by DEMSA members for clients	£4.5 billion
Total repayments made to lenders within the last 12 months	£330 million

2.3 The "average" DMP client profile for DEMSA members is as follows:

Typical client age on commencing programme	23—34
Male/Female split	45% / 55%
Average number of debts	7 (although some have 30+)
Total amount owed to unsecured lenders	£17,856
Average net annual income	£17,496
Homeowners	34%
Average successful DMP term	53 months

2.4 DEMSA member-firms are open long hours catering for the needs of their clients who are typically working professionals. Over the past 12 months DEMSA members have answered over 1,470,000 phone calls from people seeking debt advice. Of these that go on to take detailed debt advice 8.75% actually entered into a debt solution. Reasons why people may not enter a solution after advice has been given include:

- Some people feel empowered to deal directly with their lenders.
- Some just wanted some generic advice.
- Others are still looking for further borrowings.
- Some who called are worried about their debts but are actually meeting commitments.
- Those struggling to budget—perhaps because of bank charges.

2.5 Uniquely in the debt management sector DEMSA is Code Sponsor under the OFT's Consumer Codes Approval Scheme. DEMSA's Code goes beyond the minimum standards laid down by the OFT's Debt Management Guidance and other applicable industry Codes. All member-firms must abide by the Code and be independently audited on an annual basis.

2.6 Gaining OFT Approved Code status is a rigorous process. Firstly the Code itself must be developed and approved by the OFT. Each individual member must demonstrate that they meet the Code's standards and this must be evidenced in day to day practices and through the ethos of their business. Further vetting is undertaken through mystery shopping, client satisfaction surveys, audits of websites and marketing materials.

2.7 From early 2012 the compliance audits for DEMSA member-firms will be carried out by the Institute of Chartered Accountants in England and Wales. Until that time the audits will continue to be undertaken by Compliancy Services (www.compliancy-services.co.uk) which provides similar services for many FSA-regulated firms.

2.8 Members' auditors must also certify that clients' funds are all held in ring-fenced client accounts.

2.9 As a condition of its Approved Code status; DEMSA must conduct monthly client satisfaction surveys. The results for the past 3 years are as follows:

	2008 Number	2008 %age	2009 Number	2009 %age	2010 Number	2010 %age
Excellent	332	59	368	58	704	53
Good	117	21	132	21	284	21
Satisfactory	45	8	58	9	162	12
Below Satisfactory	29	5	20	3	63	5
Poor	39	7	50	8	113	9
Spoiled	0	0	0	0	0	0
Totals	562	100	632	100	1326	100

2.10 As you can see in 2010 three quarter of clients felt their debt management provider was either good or excellent. By comparison in a survey of 9,000 people published by moneysavingexpert.com at the end of 2010, only 47% of people rated the main high street banks as "great".

2.11 Whilst firms work hard to meet and exceed the expectations of their clients, clearly sometimes things can go wrong. Member-firms all have their own internal complaints procedures, but clients are additionally protected by DEMSA's dispute resolution procedure. Details of the number of complaints made to DEMSA and their outcomes for the past three years are as follows:

	2008	*2009*	*2010*
Number of DEMSA member-firms	4	8	16
Number of Complaints Handled	4	7	44
Complaints re Service Issues	2	1	17
Complaints re plan Formulation Issues	1	3	8
Complaints re Withdrawal from a Plan	1	3	8
Complaints re Adequacy of Information Provided			11
Refunds made (£)	470	400	8557
Ex Gratia Payments Made (£)	50	125	2917

2.12 Of the 44 complaints received; 17 were deemed as justified and 27 were not upheld. 40 of the complaints were satisfactorily resolved by the individual member concerned after referral to DEMSA and in 4 cases DEMSA adjudicated in resolving the issue.

2.13 As well as DEMSA's in-house dispute resolution process clients of course have the right to take complaints to the Financial Ombudsman Service. In total DEMSA members had 68 complaints referred to the FOS scheme in 2010 of which 12 were upheld and 56 rejected by the Ombudsman.

2.14 DEMSA has an independent Compliance and Discipline Panel which meets to investigate any suspected breach of DEMSA's Code. The Panel is chaired by retired High Court Judge Sir Harry Ognall DL. Other panel members include: Richard Wharton, director and general secretary of DEMSA; Caroline Siarkiewicz, executive director of the Institute of Money Advisers; Patricia Harter of West Yorkshire Trading Standards and Michael Fox a Deputy Lieutenant of West Yorkshire.

2.15 As part of its work to raise standards in the sector, DEMSA has partnered with the Institute of Money Advisers and Staffordshire University to develop a new qualification for debt advisers. The qualification is similar in scope and equal in standards to one developed by the IMA for the free-to-client sector. The 16 week course will be piloted by staff from member-firms in early 2012. The qualification is NVQ Level 4, equivalent to first year degree and will include Continuous Professional Development (CPD).

2.16 Members invest significantly in the training and development of their staff and have robust systems to provide accurate and timely information to their clients and their lenders. For example members have been recognised as "Investors in People" and achieved the Financial Services Skills Council's "Training Excellence" status.

3. Working For Higher Standards Via Self Regulation

3.1 DEMSA is fully committed to working with the OFT to promote and maintain high standards. DEMSA works to identify existing and emerging poor practices and actively reports rogue firms. In some cases member-firms have provided the OFT with evidence and witness statements.

3.2 DEMSA members meet formally with the OFT quarterly and have built a trusted partnership over many years; this enables a two way flow of information, guidance and advice.

3.3 Many of the "rogue" firms purporting to be debt managers are small, with just a handful of clients. Many are unlicensed "lead generators". In some instances their websites come and go in a matter of days.

3.4 Naturally, DEMSA contributed fully to the OFT's consultation on its new Debt Management Guidance—in particular suggesting higher standards and tighter wording to remove potential ambiguity. DEMSA is especially concerned about the legal restraints within which the OFT has to work which mean that it often takes months (in some cases over a year) to revoke the licence of a "rogue" firm, particularly as firms use the appeal process. A more appropriate approach maybe akin to food standards—where restaurant inspectors find bad practice; they can shut a business until they are satisfied that appropriate standards have been met.

3.5 DEMSA is also working with the Insolvency Service to help it develop the proposed DM Protocol, which could bring many advantages to the sector as well as certainty to the consumer. However, our concern is this will be based upon goodwill alone and not all firms; nor lenders, will choose to adopt it. We do, however, fully support this initiative and anything else that helps to raise standards and address poor practice.

3.6 DEMSA also takes an active role in contributing to industry developments by being involved in all stakeholder groups and appropriate committees.

3.7 DEMSA and its members have positive and constructive relationship with lenders. DEMSA believes strongly that lenders should be encouraged to favour debt management firms that are members of trade associations. At present lenders feel that current Guidance and Codes dictate that they must deal with any appointed third party representative—which simply allows misbehaving firms to continue providing poor service—with no requirement or, even incentive, to raise their standards.

3.8 As you know, the Money Advice Service (MAS) has been conducting a review of the debt advice sector. DEMSA and its members have been fully engaged with this review and have contributed to interviews, workshops and the sharing of data. Michael Land, DEMSA's chairman is also sitting on the MAS' project Steering Group.

3.9 DEMSA would fully endorse tougher and swifter enforcement action from the OFT. In addition the new financial regulator, the Financial Conduct Authority (FCA), will have a key role to play in enforcement.

3.10 DEMSA fully supports the benefits that statutory regulation can bring and would encourage the Government to consider this option—should the new DM Guidance, DM Protocol and the formation of the FCA not bring about the necessary improvements intended.

4. Why Do Customers Pay for Debt Advice?

4.1 There are a number of reasons why clients chose to use a DEMSA member:

— Many clients are working professionals with good incomes who have simply borrowed too much money, or suffered a change in circumstances so they can no longer service their debt at the level previously agreed. However, they don't see themselves as in need of charity.

— Some clients prefer the "anonymity" of telephone based advice and actively avoid face-to-face. Often they feel ashamed of their debts.

— Generally, people with problem debt struggle with it for many months; often they reach a crisis point which triggers them to reach out for advice. Rather than wait (the National Audit Office found waiting times of four—six weeks and that some providers had closed their waiting lists) for an appointment with a free-to-client provider some customers choose to pay for immediate help and support. Typically DEMSA member-firms are able to offer immediate advice and support at times that fit in with the needs and requirements of clients.

— DEMSA members have invested significantly in training, systems and processes that enable them to handle a high volume of calls and support an efficient "journey" for the customer.

— DEMSA members offer a high level of customer service. Clients may not want (or in some cases be able to) manage their debts themselves especially as, on average, clients have seven debts often with seven separate lenders (some have more than 30 unsecured debts). Crucially many clients say they have experienced pressure from lenders or debt collectors—often for an extended period of time—and it is the intermediary support that they are seeking to reduce or remove this stress. Clients appreciate that DEMSA members are active in negotiating directly with lenders on their behalf and do so for the life of their plan.

— Struggling with debt is known to be stressful and the link to mental health problems is now well understood. Once a DMP is up and running a client can, in effect, get on with their life—focusing instead on their work and their family.

— It's worth noting that DMPs are a "pay as you go solution". Once a client feels able to resume direct dealings with their lenders or when their circumstances improve; they can leave their Plan without penalty.

— Therefore, the success of a DMP should be judged against the client feeling they have regained control of their finances rather than just completion of the plan.

4.2 All DEMSA member-firms are required to provide transparent information pre-contractually—ensuring the indivudual understands the contract and makes an informed choice before committing to any payment and becoming a customer. Furthermore, each member-firm provides a 14 day cooling off period—seven days longer than required by law.

4.3 In the Citizens Advice Bureaux's (CAB) Super Complaint (March 2011), it suggested that debt management firms charge "up-front fees". The OFT found that DEMSA members do not charge "upfront fees"—that is they don't charge customers anything before they have fully understood the service to be provided and committed to it.

4.4 Similarly, the CAB also suggested in the Super Complaint that debt management firms cold call prospective clients. Again the OFT found that reputable firms such as DEMSA members do not "cold call" consumers.

4.5 DEMSA's remit, under guidance from the OFT, does not extend to controlling the fees charged by its members. However, typical fees for a DMP are as follows:

- The customer makes an initial payment equivalent to between one and three month's disposable income (their disposable income is assessed—after completion of a full income and expenditure analysis—to be surplus to what is needed for day-to-day living expenses and priority bills (see 5)
- Each month when the firm collects the payment from clients it will also deduct a fee (typically 17.5%) before sending the payment onto lenders.

4.6 DEMSA would support the provision of price and service comparison tables to help consumers make informed choices. The MAS would be well placed to provide these.

4.7 Its worth noting that the fees charged by DEMSA members for formal insolvency solutions such as IVAs are broadly equivalent to those charged by free-to-client sectors. Even in the free-to-client sector these fees are payable by the consumer. Administration Orders have a 10% charge for payment distribution charged by the Court Service.

4.8 Member-firms that are Competent Authorities for Debt Relief Orders do not charge fees to their client to provide this solution.

5. How a Debt Management Plan Works

5.1 A debt management plan is an informal arrangement, not a formal Insolvency Solution.

5.2 It is one of the few debt solutions where a client sets out to repay all that they owe (ie if a DMP runs to term the lender will be repaid in full). Many clients choose a DMP (even when another solution may seem more suitable) because they feel an obligation to repay all that they have borrowed, wish to avoid jeopardising their home, or because they need help to manage their debts through a shorter term change in personal circumstances.

5.3 As with all debt solutions the process starts with gaining a holistic understanding of the client's circumstance—in particular their income (maximising and reviewing benefit entitlement), essential expenditure (including arrears on priority debts) and unsecured debt commitments. This enables best advice to be given—although that's not to say that a customer always accepts the recommendation.

5.4 Income over and above that required for day to day expenses and essential living commitments is defined as "disposable income" and it is this amount that is offered, typically on a pro-rata basis, to the unsecured lenders. Generally DEMSA members have very strong relationships with lenders—which know their offers will be fair and based on accurate customer information—so the acceptance rates of offers is usually in excess of 95%.

5.5 DEMSA members actively negotiate with lenders on behalf of clients. Lenders are encouraged to freeze interest and charges, although not all will provide this concession. This is often critical for the success of a DMP. If interest and charges are not reduced or frozen; the debt may continue to grow, making it impossible to repay.

5.6 A DMP has benefits to both the client and their lenders. For the client their finances are put back on a sustainable footing and the pressure from lenders is reduced. For the lender the debt management firm provides them with regular contact, key information on their customers' circumstances and a regular repayment to their account. DEMSA member-firms collect payments from their clients at a frequency that fits with their earnings and distributes this money to their lenders. Client money paid to DEMSA member-firms is always ring-fenced, in a client account, away from company funds. Some member-firms have invested in sophisticated IT links with lenders.

5.7 Many clients choose a DMP specifically (even if it is not the "best advice" for them) because it is not formal insolvency. Lawyers, police officers, bank staff, prison officers, company directors and members of the armed forces may, for example, find an IVA or bankruptcy is either unacceptable or damages their career prospects.

5.8 The informal nature of DMPs are a key strength. Many clients use them as temporary stopgaps to cover a period of illness or unemployment or a change in personal circumstances such as relationship breakdown, and then re-commence contractual repayments once their income recovers. Others use a DMP as "breathing space" which enables them to regain control of their finances (and often their lives) and rebuild their confidence (research shows this typically takes nine months). A client leaving a debt management plan before it runs to term is therefore not necessarily a failure.

Percentage of total DMP clients that end their plan each month	2.6%
Of these:	
Completes programme and leave debt free	15%
Settles directly with lenders (for example family provide funds to clear debts)	5%
Client is empowered to deal direct with lenders themselves	17%
Due to a change in client's circumstances or lack of lender concessions client changes to another solution	29%
Circumstances improve/stop paying/won't pay	20%
Move to another provider	10%
Other (including deceased)	4%

As you can see one in five people who leave a DMP do so debt free.

5.9 In June 2009 the Money Advice Trust (MAT) charity published research conducted on its behalf by the Personal Finance Research Centre (PFRC) at Bristol University. It interviewed a number of clients of private providers (not necessarily DEMSA members) about their experiences.

The research found that clients of fee charging debt management providers were more likely to be unhappy with the service provided if their firm was NOT a trade body member (p70)

5.10 Selected client "verbatims" from the MAT/PFRC research:

> *"I didn't go to them for advice, for them to tell me what I should be doing. I went to them for them to take it on and deal with it." (Male, 40)*
>
> *"After you spoke to them you felt a little bit of relief because this could be a solution...they weren't like 'you shouldn't have got yourself into that kind of trouble, you shouldn't have done that', you know what I mean, they were saying, 'we understand, this is what we can do for you'." (Male, 50)*
>
> *"The biggest thing they said to me was you haven't got to answer the phone [to lenders]…letters, just pass them on." (Female, 40s)*
>
> *"I mean they went through everything, the smallest detail, do you know what I mean. Like I mean some people might be on medication and have to pay for the prescription so they went through all that and said, you know, 'what do you pay out every month?' They didn't leave you so you were scrimping and saving but you weren't splashing out on lavish things, they made it comfortable for you to live." (Female, 50s)*
>
> *"…we went from £750 or something like that that we had to pay out each month in debt, it dropped to something like £325 which was below half, plus the interest ended as well, which was fantastic." (Male, 40s)*
>
> *"I think it is because you think somebody is dealing with your finances you think well there's got to be a charge, you know, people are not going to do it for nothing I suppose." (Woman, 30s)*
>
> *"I thought it was quite fair actually, you know, they are a business its not like they're in it for the fun…it was just so easy and I don't mind paying them £57 like I say because I didn't have the worry…most of the time it just wasn't even in my mind, it was gone at the beginning of the month, the money had gone, you know." (Male, 40s)*
>
> *"It was like a relief in one way because you know then that every month your lenders were getting something. Whereas before it was oh God I can't pay them this month, I'll pay these then I'll wait while next month and pay them, do you know what I mean, you'd got peace of mind knowing it was being paid." (Female, 50s, paid off debts)*
>
> *"…it made me feel secure. And it made me feel that I could actually start moving forward because I'd got that sorted at least." (Female, 50s)*

5.11 Every DEMSA member-firm displays details of the Insolvency Service's guide "In Debt? Dealing with your lenders"—this is requirement of the Code and DM Guidance. In addition many firms provide additional free help, advice and resources for people with debt problems—to enable them to self manage their finances—for example one member runs the self help website (almost 10,000 consumers used this service last year).

5.12 Not everybody who calls a DEMSA member-firm can be provided with a debt solution. For example if clients are insolvent but don't qualify for a DRO and can't raise the fees to go bankrupt (typically £700) then an appropriate debt solution may not be available.

6. Quality of Advice and Service

6.1 DEMSA member-firms are required to ensure that all advice and any recommended solution is in the best interests of their client. This is a fundamental tenet of both DEMSA's Code of Conduct and the OFT DM guidance.

Most members offer clients a wide range of debt solutions. These include:

— In England and Wales: Debt Management Plan (DMP), Individual Voluntary Arrangement (IVA), bankruptcy, Debt Relief Order, Administration Order.

— In Scotland: Debt Arrangement Scheme (DAS), Trust Deed, Sequestration (bankruptcy) and Low Income, Low Asset (LILA).

6.2 Many member-firms also offer clients a wide range of other help, support and advice including:

— Income maximisation—firms will work with clients to establish if they are receiving all the benefits they are entitled to.

— Help with secured debts such as mortgages—including arranging for affordable repayment of arrears, the prevention of repossession or eviction.

— Advocacy—some firms provide advice and support for their clients if they are involved in Court action.

— Money Saving—some members help clients to reduce their outgoings by helping them find a cheaper energy tariffs.

6.3 DEMSA members employ significant numbers of staff to provide ongoing customer service to clients. This includes answering client's queries, dealing with all correspondence from lenders, negotiating repayment, interest and charges concessions and ensuring that they are renewed upon expiry. They also conduct regular reviews of the client's financial position; to ensure payment levels continue to support sustainability and to review if an alternative solution may have become more appropriate. Typically clients will speak to their relationship manager once a month (over 10,000,000 calls a year in total). Some firms also provide online tools and services to help customers view and manage their debt management plans.

6.4 Every month DEMSA members collect and distribute some 1.6m payments to lenders from their clients. Clients appreciate the flexibility of making single payments to their provider which then handles the distribution to their lenders. This is managed to fit in with the client's earning pattern.

7. The Range and Appropriateness of Debt Solutions

7.1 DEMSA believes that there is a good range of debt solutions available to suit most clients and their circumstances. Whilst some solutions may appear to overlap and the "boundaries" between them can seem hazy this generally works well and ensures clients can move between solutions as and when appropriate.

7.2 Having said that there are areas that improvements could be made. For example:

IVAs—the voting powers of lenders, when collectively combined through voting agents, has the ability to prevent access to this solution or impose unreasonably restrictive requirements on consumers.

Bankruptcy—the cost of accessing this solution, circa £700, is often beyond reach for those that most need it.

Debt Relief Order—the low debt and asset value prevents many consumers from accessing this solution, but high bankruptcy fees can leave consumers unable to use this either, leaving them with no choice.

Regulated DMPs—the Ministry of Justice consulted on the enactment of the legislation contained within the Tribunal, Courts and Enforcement Act 2007 and were unable to reach a conclusive outcome as to whether this solution might benefit the consumer and raise standards within the sector. We understand this view was formed as a result of the Plan being regulated, not the firm, therefore not adequately removing the potential for abuse.

11 November 2011

Supplementary written evidence submitted by the Debt Managers Standards Association (DEMSA)

RESPONSE TO WRITTEN QUESTIONS FROM THE BUSINESS, INNOVATION AND SKILLS COMMITTEE

1. DEMSA's main aim is to help to raise standards in the debt management sector. Of course we can only directly influence our 17 members. Although they comprise the majority of the private sector by number of Plans, there is a long tail of small firms that are not members of any trade association. As we said in our evidence we are keen to see the OFT given much tougher enforcement powers to act quickly against firms that do breech the OFT's guidance.

Firstly its important to note that the standards DEMSA imposes on its members via its OFT approved Code of Conduct are actually higher than the OFT's own debt management guidance.

Of the 129 firms that were identified as breaching its guidance by the OFT just one was a DEMSA member and that member had already taken steps to rectify the issue. (The member in question had temporarily run out of stock of the Financial Ombudsman Leaflet that we require members send to anybody who makes a complaint. This was quickly rectified).

Naturally we are not complacent. As part of our OFT Approved Code status we put in place a robust programme to monitor members and we have recently taken steps to improve that audit process.

Our independent Compliance and Disciplinary Panel has been strengthened by the appointment of Sir Harry Ognall, a former High Court Judge, who now chairs it. He has conducted a review of both how the panel operates and DEMSA's code and he proposed changes which we have now adopted.

Our independent audit process has been augmented by the appointment of the Institute of Chartered Accounts England & Wales which will conduct our annual audits of all members from January 2012. The audit includes checking the members' compliance in areas such as marketing, promotions and advertising, pre-contract activity, contract terms, payments and money handling, contact with consumers and advice and compliance and training.

DEMSA is also working to drive up standards by improving training and qualifications for members' staff. In partnership with the Institute of Money Advisors we have introduced a new debt advice qualification, developed by Staffordshire University and which is equivalent to NVQ level 4.

An addition we also monitor our members via:

- Web sweeps and desktop analysis of advertising used by members on a quarterly basis.
- Consumer Satisfaction Survey—all members issue surveys on a monthly basis, returned directly to DEMSA.
- Mystery Shopping—undertaken by an independent organisation, calling members to ensure compliance with the DEMSA Code of Conduct.
- Complaints handling—DEMSA will accept complains from consumers who have some issues with a member and will investigate and rule accordingly. This does not affect the consumers' right to invoke the Financial Ombudsman Scheme.

2. We have had one occasion in the past 12 months where we have had to invoke disciplinary procedures against a member.

This particular instance involved DEMSA becoming aware of a member using Google Adwords in a misleading way. The practice was immediately ceased and DEMSA, through the Compliance & Discipline Panel, imposed sanctions on the member company, including a fine of £15,000. As you would expect we kept the OFT fully informed throughout the process.

At the time our Code of Conduct did not permit us to name the firm as part of our sanctions. However, we recognized this as a weakness and have already amended our Code to ensure that we are able to do so, where appropriate, in future.

3. We agree that there should be far more information available about the efficiency and outcomes of debt advice and services—from providers from all sectors. All providers have a duty of care to clients, regardless of who is funding the advice, and all should be held account for the quality of advice and services they provide.

DEMSA has not up to now published the type of data you are referring to on behalf of members although we did share such data with you as part of our submission. It is certainly something we are considering doing in the future.

4. This isn't the issue. They key thing here is whether the debt management plan has met the objectives and aspirations of the client whilst they were using it. For example some clients take a debt management plan to enable them to regain control of their finances. Once they have a budget in place and a comfortable level of debt repayment that enables them to meet priority bills and reasonable living costs they are then happy to "go it alone" without the help of their provider. We would count this as a success not a failure.

As we said above we agree that we need to have data in place to measure client outcomes—across all types of advice provider. The correct measure of success, however, is whether the solution has met the needs of the client at the time.

5. We do not accept that there is a lack of awareness amongst people struggling with debt about the availability of free to client debt advice. The National Audit Office found that 97% of people in debt are aware of the services offered by Citizens Advice. In addition all consumers who default or fall into arrears are provided by their lenders with the OFT Information Sheet which clearly sets out the existence of free to clients providers.

DEMSA members must signpost the Insolvency Service's guide which also sets out the range of free to client provision available.

Clients *chose* to use a DEMSA member firm because they place a value on the services we provide. Our members are very transparent about the services they offer and the cost of those services. DEMSA members are required to advise all consumers, pre-contract, of full details of fees charged, total costs and duration of any debt management plan. We audit this via our mystery shopping and call listening.

However, we agree with other evidence that it isn't always easy for consumers to shop around between private sector providers. As we said in our submission we would welcome the provision of price, service and outcome comparison tables to help consumers make informed choices. The MAS would be well placed to provide these.

6. All DEMSA members will go into great detail with consumers regarding their income and expenditure and will explain the principles of budgeting, including the importance of prioritizing debts. Members will provide services to help the consumer to reduce bills for utilities etc and by using the Common Financial Statement will make it clear to consumers where they should be looking to make savings.

A key question asked of consumers in our Consumer Satisfaction Survey (*not printed*) is:

> "8c. Overall would you say that your programme has improved your ability to cope with your financial affairs more easily?"

In 2010 97% of consumers completing the survey replied "Yes" to this question.

7 December 2011

Further written evidence submitted by the Debt Managers Standards Association (DEMSA)

Thank for you the opportunity to present both written and oral evidence to the Committee. We hope that you found our evidence useful.

I was concerned to read the submission to your enquiry made by the Consumer Credit Counselling Service (DM16). We believe that in a number of areas they have misunderstood or been mis-informed about how DEMSA members operate. As we said in our evidence, we are not apologists for the "rogue" firms that undoubtedly exist: we need tougher enforcement action to ensure these firms improve or exit the market. But the best private sector providers actually adhere to higher standards than the free-to client sector and clients who choose to use DEMSA members say that they get real value for money—which is backed up by independent market research—commissioned earlier this year.

My comments below refer to the paragraph numbers in the CCCS submission.

— 1.2 We believe that CCCS's share of debt management plans is closer to 23% than 30%. Our information is that there are 500,000 live plans in the UK, of which 205,000 (40%) are administered by DEMSA members, 23% by CCCS and 22% PayPlan. This information is based upon the data gathered from the BBA/Accenture report.

— 1.3 The services delivered by CCCS are not unique. Many of our members deliver very similar services to their clients—such as predominantly telephone based advice, budgeting support, income maximization, priority debt arrears negotiation etc, as we set out in our submission.

— 1.7 As CCCS says, its "Fair Share" model only covers debt management plans—other services (IVAs, equity release etc) are typically charged for, in the same way as the private sector, with the fees being met by the consumer. For example a CCCS client that takes an IVA will pay broadly the same fees as a client taking an IVA with a DEMSA member firm. This includes the "Nominee Fee" charged by the Insolvency Practitioner to asses the client's circumstances, draft the proposals and gain support from the creditors.

— 1.8 Whether a client is paying a fee or not is not the best factor in determining the success of a debt management plan. Clearly the initial advice is key—the plan must be appropriate for the client's needs. The budget that is agreed with the client must be realistic and affordable and the payment sustainable.

— It is also important that lenders are encouraged and largely agree to waive, and continue to waive (as concessions are typically agreed for 6 months) interest and charges. Part of the service that our members offer is to actively negotiate with lenders, to gain their consent to not only freezing interest and charges, but also where possible and appropriate, to obtaining refunds of previously and often unfairly applied charges.

— 5.1 For clarity the £250 million referred to by the CCCS is an estimate of the annual revenue of the entire private debt management sector, not the profit.

— 5.2 Clients of reputable debt management firms, such as DEMSA members, pay nothing for advice. Our members will go through typically the same rigorous assessment of the client's budget as CCCS does (understanding in detail the client's family circumstances, income, priority bills, living expenses and expectations etc). Building this picture of the client typically takes 40 minutes to an hour, although can often be longer. Only at this stage can we offer detailed advice.

  Even where a debt solution is recommended, there is still no obligation on the client to take it. Clients receive, in writing, all the information they need to make an informed choice including full details of fees payable—both initial and ongoing—so they fully understand the service they will receive and the total cost. Only at this stage, if a client chooses to go ahead, would they make a payment. Clients of DEMSA member firms benefit from a 14 day cancellation period—with a full refund during this period.

- 5.3 This scenario is not typical of a debt management client that our members or CCCS would usually encounter. In most cases clients with higher levels of debt, such as the £30,000 referred to, would be more appropriately suited to a solution that offers some debt write off. Clearly it will depend on the detailed circumstances of the individual, but the most appropriate advice is likely to be an IVA. This would usually see the client debt free in five years and DEMSA members would charge broadly the same fees as CCCS' Insolvency Practitioners.
- 7.3 Whilst there are a significant number of free to client and fee charging debt advice organisations in the UK, there are only 11 "Competent Authorities" approved by the Secretary of State to accredit Intermediaries to offer access to Debt Relief Orders—two of which are DEMSA members. Although not all member firms are Competent Authority approved, this does not prevent them from offering best advice, as a client for whom a DRO was most suitable would simply be referred to any of the 11 Competent Authorities—in the same way as a free to client provider, who was also not approved.
- Similarly the Debt Arrangement Scheme in Scotland is widely seen as being better for the consumer than debt management and is generally therefore more appropriate due to the regulatory framework. Some DEMSA members are approved to offer DAS directly. CCCS offers advice in Scotland but does not offer DAS directly—it simply refers clients on.
- 7.6 Many DEMSA member firms offer a wide range of additional support to clients including benefit entitlement checks, support and help with priority debts/arrears, support with legal actions and bailiffs etc.
- 7.8 It should be noted that the standards that DEMSA members adhere to, and are regularly independently audited and are in fact higher than those set out in the OFT's own Debt Management Guidance.
- 7.9 DEMSA is committed to raising standards across the sector and would welcome any organisation, including the CCCS, which could meet the required standards and pass the necessary audit. We believe however, that CCCS could not currently be admitted as a member as we understand that it distributes clients' funds to lenders only once a month, which may well bring consumer detriment—due to the impact of any interest and charges. This point has been raised with the OFT, as their Debt Management Guidance currently requires all firms, regardless of whether their services is provided free or for a charge to the client, to distribute funds within five working days of receiving cleared funds.

The CCCS is quite right in saying that DEMSA did not name the firm recently censured by its Compliance and Discipline Panel. The Panel recognised that its Code needed strengthening in this area and has already taken steps to amend it to enable firms to be named, when action is taken against them. This change is currently awaiting OFT approval.

Richard Wharton
General Secretary

9 December 2011

Written evidence submitted by The Debt Resolution Forum

1. Summary

1.1 *Debt Resolution Forum*: DRF is a trade association with 29 full members. We provide academically accredited training, authoritative independent monitoring and an independent complaints procedure for the debt resolution industry. We are in the course of obtaining OFT consumer code approval for our standards.

1.2 *Personal Insolvency*: Debt resolution companies offer advice on debt solutions free of charge and charge for the implementation and operation of formal and informal debt repayment plans. DRF believes that the perception that free advice is good advice is often wrong and that a level playing field between free to client and fee charging commercial organisations would benefit debtors and creditors—and ensure access to appropriate debt advice for all.

1.3 *Debt Advice*: DRF believes financial education would make little difference to debt resolution, because high levels of innumeracy and illiteracy amongst the group who would benefit most mean they would be unable to take advantage of it. Most intractable debt is caused by a sudden change in circumstances and debt levels are much higher than formerly, partly because high levels of debt are required to fund consumer spending that plays a significant role in Britain's economic growth. A debt resolution culture that encourages consumers to repay, is affordable and achievable and which rehabilitates debtors as a reward would, DRF believes, create more positive outcomes and encourage people to deal with debt early.

1.4 *Range Of Debt Solutions*: DRF believes there is an opportunity to create a more effective and balanced set of debt resolution options for consumers by combining the best features of the Scottish Debt Arrangement Scheme, the Enforcement Restriction Order and the original concept of the Simple IVA into a single process. Bankruptcy needs to be available for those who cannot afford to repay debt, but debtors who can pay, but won't, should be encouraged to use a debt repayment solution like a debt management plan or individual voluntary arrangement.

1.5 *Access To Debt Solutions*: DRF believes new OFT debt management guidance, trade association membership and monitoring mean that compliant fee-charging debt resolution companies will offer appropriate advice and signpost debtors to free to client sources when this is appropriate. Training means debtors can have confidence in advice from DRF member companies. Over standardisation and simplification of advice models can mean debtors receive inappropriate advice. Introducing simplified procedures may reduce costs.

1.6 *Consistency Across Debt Solutions*: Consistency in calculating income and expenditure is vital. But rigid application of guidelines leads to poor decision making in cases that don't fit the model. Creditors should be encouraged to reward debtors who choose to repay debt and perform when doing so by rehabilitating them and providing access to financial services on the same terms as customers who have not experienced debt problems.

2. Debt Resolution Forum

2.1 *Who we are*: Debt Resolution Forum (DRF) is a trade association for fee charging companies that provide debt resolution services for indebted consumers including:

— Individual Voluntary Arrangements.

— Debt Management Plans.

— Bankruptcy Advice.

— Repossession Advice.

2.2 *Membership*:[54] DRF currently has 29 full members (trading companies providing debt solutions), three provisional members (trading companies who have not yet fulfilled all DRF's membership requirements), two affiliates (companies that provide services—eg software—to our members) and one introducer member (introducers are companies that refer consumers for debt advice: this is an area we are expanding).

2.3 *Standards*:[55] DRF has a set of standards with which members are required to comply (members sign an annual return indicating their compliance, which is subject to inspection (see 2.5 below).

2.3.1.1 DRF is currently applying for Office of Fair Trading (OFT) consumer code approval and is close to completing stage one of the scheme. The standards exceed those required for both the current and forthcoming OFT Debt Management Guidance.

2.3.1.2 DRF's standards cover:

— *Section A*: Standards applied by DRF members in their work with and on behalf of debtors.

— *Section B*: Standards applied by DRF members in their dealings with creditors.

— *Section C*: The training, qualification and continuing professional development of DRF members' management and staff.

— *Section D*: Corporate standards of governance adopted by DRF members.

— *Section E*: Client Funds.

— *Section F*: Advertising and Publicity.

— *Section G*: Fees and other charges.

— *Section H*: Complaints.

— *Section I*: Statements/reviews/information provided by the DRF.

— *Section J*: Regulatory Framework.

— *Section K*: Development of standards.

2.4 *Training*: DRF members are required to train their client-facing staff to the standards of the Certificate in Debt Resolution (CertDR). This is an EdExcel academically accredited qualification for which DRF is the training and examination centre.

— Module 1
  — Unit 1 The debt market.
  — Unit 2 Debt resolution.
  — Unit 3 Debt regulation and ethics.

— Module 2
  — Unit 4 The implications of over-indebtedness.
  — Unit 5 Improving disposable income and making use of assets.
  — Unit 6 Debt resolution through unsecured restructuring solutions.

[54] A list of members at the date of writing is appended to this response. A complete and fully up-to-date list of members and their trading styles can be found here:
http://www.debtresolutionforum.org.uk/members.php

[55] Current standards are always published here:
http://www.debtresolutionforum.org.uk/resources/debt-resolution-forum-integrated-standards-121110.pdf

- Unit 7 Negotiated debt reduction solutions.
- Module 3
  - Unit 8 Evidencing client advice and servicing.
  - Unit 9 Case studies.

2.4.1 The qualification requires 210 hours study across three papers covering all aspects of advice for consumers with debt issues. A score of 70% is required to pass each paper and approximately 70% of candidates pass first time. The qualification is considered to be to post A-level standard.

2.4.2 Currently 152 learners have achieved the Certificate and are allowed to put CertDR after their names. A further 100 have taken the "Award" achieved on successful completion of the first module. There are a further 245 registered learners.

2.5 *Inspection & Monitoring*: DRF has arranged for annual inspections of members' compliance with DRF and OFT standards by the Insolvency Practitioners Association (IPA),[56] one of the recognised professional bodies authorised by BIS (through the Insolvency Service) to authorise and inspect licensed insolvency practitioners.

2.5.1 Monitoring is undertaken over a three-year cycle. The first year requires a five day "visit" by a team of two inspectors, three days on site and two days spent examining websites, written material and report writing. In years two and three there is a one-day site visit (and two days for off-site monitoring and reporting), unless areas of serious non-compliance have been discovered and require to be reassessed.[57]

2.6 *Complaints Resolution*: DRF has an independent complaints committee[58] with a majority of lay members, currently chaired by David Hawkes, National Money Advice Co-ordinator of Advice UK. DRF will hear complaints from consumers and creditors.

2.6.1 DRF's complaints procedure[59] does not interfere with the consumer's right to use the Financial Ombudsman's complaints scheme.

2.6.2 DRF has a range of sanctions to apply to members against whom complaints are upheld, including exclusion from membership and publicising upheld complaints.

2.7 *Responses to consultations, influencing public policy*: DRF participates in public consultations[60] wherever possible and has made responses to papers including:

- Ministry of Justice consultation on regulated debt management plans.
- OFT response to Citizens Advice super-complaint on up-front fees and cold-calling.
- OFT consultation on proposed debt management guidance.

2.7.1 DRF has dialogue with the OFT and, more recently, with the Money Advice Service. DRF is participating in the Insolvency Service review relating to protocol compliant debt management plans. DRF was a member of the IVA protocol standing committee.

2.7.2 DRF is a member of Money Advice Liaison Group (MALG).

2.8 *Future plans*: DRF's plans for 2012 include:

- Introduction of a Diploma level qualification, initially with modules covering advanced advice on benefits and helping especially vulnerable people.
- Introduction of compulsory continuing professional development for CertDR holders, including basic training on dealing with more vulnerable consumers.
- Introduction of a monitoring/accreditation scheme for lead introducers.
- Introduction of "chapters" to facilitate communication with creditors and free advice bodies.
- Development of desktop monitoring of members' cases.

3. Personal Insolvency

3.1. *Free and Impartial advice*: DRF members charge for their services but do not charge for their initial advice, which is often considerable. We are transparent about our charges, compliant with OFT guidance and will advise on and signpost all solutions, even when we cannot charge for them.

3.1.1 DRF is concerned that advice from free-to-client organisations is not always appropriate advice and believes these issues were not looked at in any depth by the BIS "call for evidence". For example:

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[56] More details about the IPA can be found on their website: http://www.insolvency-practitioners.org.uk/
[57] Examples of redacted inspection reports can be supplied on request.
[58] http://www.debtresolutionforum.org.uk/complaints-committee.php
[59] http://www.debtresolutionforum.org.uk/complaints-procedure.php
[60] Copies of DRF consultation documents are available on request.

— Many plans offered by free-to-client providers do not offer anything beyond advice when a debtor is unable to cope with the requirements of making individual payments to creditors.

— Where distributions are made by free-to-client providers, or on their behalf, we understand that these may not include minimum distribution arrangements and that the costs incurred may not be clear to consumers.

— In some cases, free to client companies offer token payment DMPs when this is not the most appropriate advice for the client (frequently, bankruptcy is the correct alternative).

— Some free-to-client advice agencies appear to offer a far lower proportion of specific debt solutions (for example, IVAs) than volume and demographics indicate they should. This under advising could significantly harm many hundreds or thousands of consumers.

— Many indebted consumers can afford to pay for debt advice (a cost, DRF believes, that should be shared with creditors).

— Some free to client advisers may charge for some of their services, yet not be open about that to the consumer.

— Some free to client services and debt advice charities provide leads, for payment, to other providers without revealing this arrangement to the debtor.

— The free advice sector does not have the capacity to offer all the debt advice required by British consumers.

3.2 *Regulatory Landscape*: DRF believes that the forthcoming revisions to OFT Debt Management Guidance and probable accompanying enforcement action will help create a fee-charging debt resolution sector that consumers and creditors can trust. We welcome and support this and believe we have been instrumental in putting in place the training, monitoring and complaints procedures that make this possible.

3.2.1 However, DRF is concerned that the current and proposed regulatory framework does not create a level playing field between fee-charging debt resolution companies and free to client providers (whether charitable or creditor-funded). For example, the proposed OFT debt management guidance currently requires fee-charging debt resolution companies to take steps to ensure their evaluation of a consumer's debts and ability to repay is accurate, this obligation is not placed on free-to-client providers. Clearly, advice based on inaccurate information is worthless.

4. Debt Advice

4.1. *Intervention by Lenders*: DRF considers that lenders should be encouraged to determine whether a non-performing debtor has other debts with which the debtor is struggling. Where this is so, and the debtor indicates they cannot meet their commitments, a creditor should be encouraged to refer the debtor for advice on all her/his commitments.

4.2. *Financial Education*: DRF is concerned that financial education, whether of adult consumers, school pupils or higher education students, is seen as a panacea. We believe that, even if well-funded, it would have low impact on debt.

4.2.1 We believe that relatively few consumers get into debt because theyfail to understand the consequences of taking credit or failing to calculate whether they are overburdened.

4.2.2 There are clear indications that most consumers fail to repay debt because they suffer a financial shock (redundancy, partnership break down, illness, uninsured loss, childbirth are all common examples).

4.2.3 This financial shock may be more common in times of economic difficulty—but insolvency statistics show that a rise in indebted consumers seems to have a lagging relationship with availability of credit and an inverse relationship with numbers receiving jobseekers allowance.

4.2.4 Consumer insolvencies run at roughly five times the level experienced at the end of the 20th century and this looks set to persist because consumer spending seems a significant contributor to UK economic growth and because we are a nation of borrowers, not spenders.

4.2.5 Whilst financial education could be of long term benefit it will not reach the most vulnerable, who are much more likely to require debt help: For the last twenty years one fifth of UK school leavers have entered the employment market functionally illiterate and innumerate. Until that is rectified, they would be unable to use any financial education they received.

4.2.6 Rather than financial education, DRF believes that it will be less costly, and more useful to both individual debtors and the economy as a whole, to concentrate on creating a rehabilitative debt culture: The biggest issue facing consumers is, because the stress, worry and fear of the consequences of debt, they take advice much later than they should which generally means the owe more, can pay less and the consequences of their debt are more onerous. It also means they usually are able to repay less of what they owe.

4.2.7 DRF believes debt management plans (DMPs) and IVAs are both intrinsically rehabilitative, as a consumer chooses to repay as much of their debt as they can afford, rather than walking way (which bankruptcy—whilst the consequences are drastic—usually allows).

4.2.8 DRF believes that consumers should be rewarded for demonstrating that they can manage their money (in an IVA or DMP) by agreement from creditors to allow them access to financial products at prime rates. Bankruptcy and DROs should be available for the most vulnerable and those without property assets but should be as punitive as it is now (with a higher rate of Income Payments Agreements and Orders) to incentivise those debtors who can pay to choose a more rehabilitative (and productive for creditors) regime.

4.3. *Free advice*: As noted above, DRF believes the fee-charging debt resolution sector has a role to play in helping UK debtors and that there are issues in ensuring there is a level playing field between free to client and fee-charging providers.

4.3.1 DRF also believes that consideration should be given to developing a new debt resolution procedure for England and Wales that could be provided, at reasonable cost by both fee and free sectors and which would embody the best features of the Scottish Debt Arrangement Scheme (DAS) the (never implemented) Simple IVA and the Enforcement Restriction Order (an enacted but unused provision of the Courts, Tribunals and Enforcement Act 2007 that provides for a stay on creditor actions in certain circumstances). DRF believes that introduction of the ERO could have saved many thousands of people who have become unemployed in recent months from returning to work with an irretrievable debt problem.

5. Range of Debt Solutions

5.1. *Debt relief options—balance*: DRF believes that, by and large, the procedures available to debtors are fair and effectively balance the interests of creditors and debtor. However, evolving debt solutions, so that they encourage debtors to repay as much as they can, whilst learning how to manage their money, would have a profound effect on people's attitude to debt and ability to cope as consumers. Behaviour is unlikely to change whilst consumers have an overwhelming fear of the consequences of debt. This could be changed by making the most productive debt resolution procedures more rehabilitative, by easing access to debt resolution for the most vulnerable and by requiring creditors to rehabilitate debtors as future customers when they show they can manage their money and repay what they can afford.

5.2. *Improving current debt solutions*: DRF believes consideration should be given to a procedure resembling Scotland's Debt Arrangement Scheme, where the debtor undertakes to repay all the principal of their debt but where creditors are bound to freeze interest and charges whilst the debtor complies with the scheme. This could be combined with the Enforcement Restriction Order (ERO) (see 4.3.1) to maximise achievability. Should a debtors situation worsen, then a review of the DAS type procedure could lead, where appropriate to the debtor passing, without further creditor agreement, into a Simple IVA, allowing some debt forgiveness.

5.2.1 Consideration should also be given to stand-alone utilisation of the Enforcement Restriction Order. Creditors rarely allow any allowance for contingencies in DMPs (unlike IVAs). Use of EROs would allow many more DMPs to be completed successfully and would reduce debtors' costs in many cases.

5.3. *Flexibility*: DRF believes a single procedure, which could be varied as the debtor's situation demands (as envisaged in 5.2 above) could provide all the flexibility necessary to establish a best of breed debt resolution culture.

5.4. *Moratorium*: The presence of a moratorium on creditor action is rarely necessary in the case of a commercial debt management plan or an IVA, as it can usually be arranged sufficiently quickly to avoid negative consequences for the debtor (and creditors, by and large, co-operate when aware that a plan is mooted. There are, as always, exceptions).

5.4.1 A moratorium may have the unintended consequence of simply creating a breathing space within which debtors do nothing: There are indications that half of all those with debt problems exhibit symptoms of mental illness (especially depression) and failure to respond to a lifeline is very common.

5.4.2 However, if legislative time was available, or if a protocol could be agreed with creditors, on balance, a moratorium would be helpful.

6. Access to Debt Solutions

6.1 *Where to go for debt advice*: DRF believes that the OFT's debt management guidance, due to come into force early in 2012, will make it possible to take enforcement action against fee-charging companies who offer solutions other than on the basis of appropriate advice. Monitoring by trade associations will support this. However, fee charging companies who are members of trade associations and who are subject to monitoring (DRF only, to date) already offer advice on the basis of client need and preference.

6.1.1 It is therefore DRF's view that inappropriate advice is unlikely to be a significant issue going forward and that, where a client cannot afford a fee-charging plan, they will be signposted to other appropriate solutions.

6.2. *Confidence in appropriate advice*: Advisors who hold CertDR and who work in fee-charging companies have generally received more training and to a higher standard than, for example, those who hold the Institute of Money Advisors qualification. DRFs standards (and the new OFT debt management guidance) should combine to ensure debtors receive appropriate guidance, whether a fee-charging company has a suitable product or not (in which case the debtor will be signposted to appropriate advice sources).

6.2.1 The same cannot be said for free to client debt advisers, where IVAs appear to be under-recommended and minimum payment debt management plans are often preferred to bankruptcy.

6.3. *Do debtors end up in the "wrong" solution?* DRF believes that there is an element of choice for the debtor in the debt solution they prefer (a debtor with a great deal of equity in property may prefer a debt management plan to an individual voluntary arrangement, for example). In most cases it is clear that there is usually a "right choice" from the procedures available.

6.3.1 However, DRF believes that debtors' situations vary widely and are less capable of a standardised response than, for example, they were when they were seeking credit. It is possible for different advisers to recommend different solutions and for both to be appropriate. The debtor's concerns need to be fully addressed the consequences of those choices clearly explained to them.

6.4. *Can costs be reduced?* A new procedure, such as that outlined above, might be capable of being operated at costs below those of current procedures, across a book of cases, thus creating more value for debtor and creditor.

6.4.1 However, there are currently issues with creditors in IVAs who try to drive down IVA fees to levels close to, or below, the costs incurred in putting the arrangement in place and subsequently supervising it. This behaviour may be restricting access to the most rehabilitative of debt solutions.

6.4.2 DRF is concerned that funding Money Advice Service through creditor contributions may make access to debt advice more problematic because the creditors may become unwilling to also provide the "fairshare" funding that currently underpins a number of free to client advisors.

6.4.3 DRF believes that transparency, a level regulatory playing field and competition between providers will create the lowest fees possible, and the highest standards of service.

6.4.4 DRF believes that consideration should be given to partial funding by creditors of all debt solutions—as they benefit from effective debt resolution, just as does the debtor.

7. Consistency Across Debt Solutions

7.1. *Calculating Income & Expenditure*: Consistency in calculating income and expenditure is key to ensuring debtors are making their best efforts to repay what they owe and that the repayment plan is affordable and achievable. There are two commonly accepted sets of guidelines that most organisations use both of which are acceptable.

7.1.1 However, debtors' cases are all individual and rigid insistence on guidelines sometimes means debtors are denied access to a procedure or that it is set at levels it is difficult for a debtor to achieve. Whilst creditors and creditor representatives are rarely completely inflexible, this could be improved.

7.1.2 Unexpected and necessary expenditure by a debtor is a common reason for the failure of a DMP, because creditors will rarely allow a sum for contingencies (say repairs necessary for a commuter vehicle to pass an MoT). Contingencies are usually allowed in an IVA. These means DMPs usually require a higher monthly contribution than an IVA with similar income and expenditure and the DMP is also less flexible and more likely to fail. This could be improved.

7.2. *Outcomes of debt remedies and future access to financial services*: DRF believes that creditors should give credit to debtors who enter schemes that encourage repayment and, where the debtor performs well, this should be reflected in future credit scores.

7.2.1 Bankruptcy should be considered as a procedure of last resort and, along with the Debt Relief Order, a no blame, no stigma, procedure for those who do not have the resources to repay debt.

7.2.2 For debtors who can repay, bankruptcy should be seen to be an onerous option without the rehabilitation that comes from choosing to make the effort to repay debt.

7.3. *Common Entry Point or "Gatekeeper"*: DRF doubts that a single entry point could, with current technology, be sensitive enough to the needs of a debtor to be fully effective.

7.3.1 The information provided by debtors in the initial advice call is often significantly different to that provided when an advice pack is returned with the debtors' documentation (statements, pay slips, etc).

7.3.2 A single entry point could guide debtors to agencies who prefer specific solutions and may not advise appropriately on the full range of options.

7.3.3 If there is a level playing field for debt advice and if fee-charging debt resolution companies can demonstrate they are transparent and compliant, then competition will encourage efficiency.

Low cost and the development of services without consumer detriment. A single portal would stifle this.

18 November 2011

Supplementary written evidence from the Debt Resolution Forum

RESPONSE TO WRITTEN QUESTIONS FROM THE BUSINESS, INNOVATION AND SKILLS COMMITTEE

1. [to DEMSA and DRF] *What have you done since the OFT investigation to improve standards in your industry? What evidence do you have of improvements?*

DRF was founded with the aim of raising standards, by a group of like minded individuals and firms that believed lip service only was being paid to this by other parts of the fee-charging debt resolution sector.

Our principal concerns were to create a set of standards that would inspire public confidence and to back these with requirements that would, in themselves, raise standards.

We therefore:

— Introduced the Certificate in Debt Resolution—an academically accredited qualification requiring 210 hours study and three written exams. DRF members client-facing staff either have to have this qualification or train to the same standard. DEMSA have begun the process of offering a version of the less-demanding Institute of Money Advisors Qualification, but do not, we believe, require it. Nearly 600 people have taken, or are taking, CertDR.

— Put in place a trusted independent professional body to monitor DRF members compliance with DRF and OFT standards. This is the Insolvency Practitioners Association (IPA), one of the bodies that is trusted by BIS to regulate licensed insolvency practitioners. A redacted report of one of IPA's three-day visits to a DRF member accompanies these answers. DEMSA are in the process of setting up a similar arrangement with the Institute of Chartered Accountants in England and Wales.

— Put in place an independent complaints committee (see answer to Q. 2, below)

Every member signs an annual declaration that they are compliant with DRF's standards (which further require members to be compliant with OFT and other relevant standards).

DRF is working closely with the OFT to obtain accreditation under the OFT's Consumer Codes Approval Scheme. DEMSA has this already. DRF considered it a priority to put training and monitoring in place in order to ensure consumers could trust the advice given by DRF members and that they could be assured that DRF members are meeting appropriate standards.

2. [to DEMSA and DRF] *How many firms have broken your trade association codes in the last 12 months? What action have you taken against them?*

DRF operates an independent complaints committee (composition and operation of which was detailed in our written evidence).

So far we have only had one complaint that has reached a formal hearing which was not upheld.

We do get informal complaints which we endeavour to resolve with the member concerned and, in most cases, the consumer achieves satisfaction.

However, in addition to this, the IPA inspection process identifies non-compliance. Where this is minor, DRF asks members to commit to correct the areas concerned and this will be specifically inspected by the IPA in a subsequent annual visit.

In the case of more serious or persistent non-compliance, DRF can ask the IPA to re-inspect the member at an earlier time (at the members cost) or could itself lay a complaint against the member, which could lead to membership being rescinded.

All upheld complaints will be publicised (including the member's identity).

3. *Last week we heard that there needed to be much more transparency in the commercial debt advice market—would you agree? Do you currently publish figures on, for example, the number of people you recommend an individual voluntary arrangement or debt relief order? If not why not?*

Transparency is a serious issue, and not just in the fee charging sector.

In the last year (Q2 2010–Q3 2011), DRF members advised on 24,281 new debt management plans (DMPs) and 6,841 IVAs.

We do not have older data, but will be collecting data quarterly, going forward. We do not require members to keep figures on solutions recommended that do not result in cases being taken forward.

However, DRF has received a substantial grant to fund research into fee-charging debt resolution procedures and their outcomes. This is being tendered for at present and will be undertaken in 2012.

DRF is concerned that the current uncertainty regarding the funding of free-to-client debt advice (and other issues) is affecting the behaviour of both free-to-client advisors and fee-charging companies and that this may not be understood by regulators or consumers.

For example, hybrid models appear to be emerging where free to client providers and charities are providing introductions to fee-charging debt managers. For example, Fee charging debt management company Baines & Ernst here (http://www.consumeractiongroup.co.uk/forum/showthread.php?324212-Bill-to-promo) admits that it pays referral fees to Citizen's Advice.

A charity, Debt Advice Foundation, provides "access to free debt advice" and debt education services through a limited company that it owns, Debt Advice Foundation Limited, which has a debenture, registered at Companies House, which indicates that it refers proposals for Individual Voluntary Arrangements, in return for a referral fee to "free-to-client" provider PayPlan.

It appears that free-to-client provider CCCS advises IVAs on a very different basis to the fee-charging industry. Average debt in a CCCS IVA appeared, in 2010, to be around £55,000—roughly 40–50% higher than would be expected across IVAs in general.

It is understood that both Money Advice Trust (MAT) and Citizen's Advice are, in certain circumstances, paid fees by CCCS. For example, it is understood that the latest MAT accounts show £700,000 was received from CCCS and £600,000 from PayPlan.

In addition, there are questions of transparency and "level playing field" issues with the proposed new OFT debt management guidance.

For example, CCCS's "Debt Remedy" online system appears to operate outside OFT guidance by prompting debtors to input income and expenditure figures that match creditor guidelines, rather than by putting in the debtor's specific situation.

Further, the proposed OFT guidance requires fee-charging debt resolution companies to obtain accurate information on debtors income and expenditure but appears to exempt free-to-client companies from these strictures. Par 3.21 (a) (p 39) of the proposed OFT guidance relates to:

> "failing to take reasonable steps to verify the consumer's identity, income or outgoings".

Footnote 58 is attached to this paragraph and states:

> "This is primarily aimed at commercial debt advisers and debt management companies rather than the not-for-profit advice sector. While we would expect licensees to take reasonable steps to verify income and expenditure by appropriate means, what is "reasonable" and "appropriate" will depend on the circumstances and the nature of the service being provided in each case".

4. *What percentage of your debt management plan customers are still making their debt management plan payments after 24 months?*

DRF does not collect this data.

However, anecdotally, we believe that around 50% of fee-charging debt management plans are still in force at the end of year two.

Much of the attrition in debt management plans appears to take place in the first few months, where debtors either recover from a temporary inability to cope or enter into an appropriate insolvent solution (DRO, Bankruptcy or IVA).

However, those that continue beyond the first 12 months of contributions and whose circumstances do not change have a higher probability of continuing. It appears that around 80% of those plans in force at the end of year two are still continuing at the end of year five.

5. *Do you make people who contact your organisations aware of the availability of free debt advice? Should you?*

DRF's standards state:

> "DRF members must provide advice which is:
>
> — *consistent;*
>
> — *objective; and*
>
> — *impartial.*
>
> free at the point when they are first contacted by the debtor".

Most of the extensive advice provided by fee-charging firms is free: Only a minority of cases result in a fee-charging relationship with a debtor.

In addition, DRF's standards state that members "*must make clients aware of the sources of free-to-client advice*". This is over and above the requirement in the OFT's debt management guidance.

6. *Do you educate people who come to you about financial planning and budgeting so they are better able to manage their finances in future? Do you think there is capacity for you to do more of this?*

DRF members are under no obligation to educate debtors. However many do, through email newsletters and references to blogs, etc, which help debtors manage their money effectively.

Most fee-charging debt resolution companies provide a higher level of continuing client support throughout the plan than free-to-client services, including regular reassessment of a client's situation, assistance with creditor harassment and a "robust friend" when a client is unable to pay their monthly plan contribution.

DRF is concerned that much of the current pre-occupation with financial education is ill-judged and likely to be ineffective:

- — 50% of people with debt problems are only unable to manage their debt because of an individual "financial shock".
- — Most of the rest fall behind because of a more generic economic change (rising interest rates, increased unemployment, etc).
- — Failure through irresponsibility is rare.
- — 20% of UK school leavers are functionally illiterate and innumerate.
- — The illiterate/innumerate are likely to be concentrated amongst the most excluded citizens of our society and are also, we believe, more likely to use credit without the necessary understanding of how to control it. However, financial education will not benefit them as they do not have the basic tools to use it.
- — The process of debt repayment in IVAs and DMPs encourages people to learn to manage their money (not necessarily true of bankruptcy).
- — Therefore financial education is unlikely to be required by most debtors and cannot be acquired, because of lack of basic skills, by most of those who need it.

DRF would recommend that, instead of financial education, which would take curriculum time and resources away from renewed efforts to bring about universal literacy and numeracy, that resources should be devoted to the creation of a debt resolution culture that rewards those who do not walk away from debt by creating repayment plans that are affordable, achievable, represent the debtors' best efforts and which, on completion, reward the debtor by removing stigma and restoring the financial status that enables them to obtain the financial products they need at rates that are not subject to penalties imposed because of their previous payment record.

7 December 2011

Written evidence submitted by Fairpoint

Introduction

In a period of exceptional strain on household budgets, there is growing need to ensure delivery of sustainable, high quality debt management services. Yet a number of challenges raise a question mark over the ability of the current regime to achieve this.

Fairpoint are delighted that the Select Committee is looking seriously at this issue. We are eager to see sufficient availability of quality support, tailored to those who need it, as well as to encourage uptake of timely help where it is needed. Improving standards within the sector is critical to each of these objectives.

We believe the following issues are most pressing:

- — The need to ensure a quality service.
- — The need for more free products.
- — The need to ensure the right service for the right people and encourage uptake.

We believe that a robust regulatory landscape must address these challenges and improve standards for the consumer.

About Fairpoint

Fairpoint plc is a commercial organisation calling for higher standards in the debt management sector. For the past two years we have provided a free service through our debt management business, ClearStart, which belongs to an industry body approved by the OFT.

ClearStart offer no-obligation advice and free debt management plans. In addition, we offer a range of paid-for debt solutions where these will lead to the best outcome for the consumer. This is true of other providers of free advice, such as CCCS and Payplan, and our products offer equal terms to charities.

Personal Debt: a Growing and Overlooked Problem

With sluggish economic recovery, rising inflation and stagnating wages, debt is an increasingly mainstream issue. Our research shows that hard working people, notably women, public sector workers and young families, are being pushed into difficulty. There is a particular need to encourage those who are struggling with money to seek help and advice: research shows just one in six with a debt problem currently seek advice.

It is vital that the right network of support is in place, with responsible and tailored provision available, to help these different sections of society struggling with their finances.

Barriers to Quality Provision

Current steps to drive up standards in debt management include the OFT review of guidance. Fairpoint welcome this focus; however, we believe there are omissions and shortcomings which will have unwanted consequences, and prevent the guidance from achieving its objective of improving standards.

Below we outline a sample of examples we believe represent barriers to quality provision:

- Minimum quality standards, applied equally across the "free" and commercial sectors are vital to protect the consumer and promote transparency. Yet there is no attempt in the guidance to set out quality standards for the provision of advice.
- There is no guidance on appropriate use of debt solutions, vital to ensure the best outcomes and empower the consumer.
- There are no guidelines as to when interest should be frozen, a step which would provide safeguards for both debtor and creditor.
- The guidance recommends cost of credit becomes the driver of contributions to creditors, a policy which potentially risks encouraging creditors to drive up interest rates.
- The guidance appears to place a number of obstacles in the way of early intervention, crucial in achieving the most satisfactory outcome for debtors and creditors alike.
- Guidance does not allow for all providers of free debt management plans to use the same wording in describing their services. This hinders transparency, consumer confidence and choice.
- There is no guidance to promote the fairshare model, which would create much needed additional capacity for free debt management plans.

At a time when household finances are under increasing strain, we must ensure that such issues are ironed out, removing barriers to quality provision of financial advice and practical help.

Is Guidance Enough?

Any guidance is likely to be embraced only by those organisations already committed to high standards. We wonder if the guidance goes far enough to restrict irresponsible practice, or whether a move towards improved regulation is required.

The existing regulatory system has allowed growth amongst low quality providers who often cause more harm than good. It must be improved, to protect consumers from irresponsible credit solutions and ensure adequate provision of quality help and advice to those who need it.

Growth of low quality providers has left many with the impression that private sector involvement in this area is always poor quality and not in the consumer interest. This is not the case.

Whether guidance or regulation, it is vital that standards are implemented consistently, across all practitioners involved in the debt solutions market.

Improving Standards and Ensuring Provision

We have drawn on our knowledge base and experience to undertake a root cause analysis of the problems which exist in the industry and we believe there are a number of simple steps to remove problems inherent in the provision of debt solutions. We would be delighted to have the opportunity to discuss this with you in further detail.

The key components required are: a balanced and fair system; quality, targeted advice; early intervention; and a transparent and level playing field for all responsible providers.

We believe that there are reasons why responsible, high quality providers in the private sector need to be involved in this:

- It is vital that we ensure the support infrastructure contains a range of options which cater to the needs of changing demographics, as those facing debt problems are made up of an increasingly high proportion of hard-working professionals.
- Free advice and free debt management plans must be available to people suffering financial stress, yet budget cuts and capacity issues will limit capacity of charities and Citizens Advice.

— Consumers must be able to access quality advice in a timely fashion to ensure early intervention.

— There is an assumption that all providers of debt management solutions are the same, but this is not the case.

Crucially, all organisations, whether public, private or voluntary, should be required to demonstrate adherence to minimum standards of advice and delivery.

14 November 2011

Written evidence submitted by the Finance and Leasing Association (FLA)

Executive Summary

— UK borrowers have benefited from extensive recent changes to consumer credit regulation (including the new Consumer Credit Directive, implemented only this year). There are nonetheless some sensible amendments which could improve the functioning of the current regime, based on the Consumer Credit Act (CCA).

— But to avoid considerable market disruption, the Government's proposed transfer of consumer credit regulation from the Office of Fair Trading (OFT) to the new Financial Conduct Authority (FCA) should take place on the basis of the current legislation.

— Any new regime should then be designed and implemented on a realistic timetable. Simply applying the Financial Services and Markets Act (FSMA) will not work. A proportionate approach is needed, reflecting the structure of the credit markets (including, for example, the large number of non-banks and the thousands of intermediaries).

— The evidence presented to the Department for Business, Innovation and Skill's (BIS's) Consumer Credit and Personal Insolvency Review (CCPIR) showed that interest rate caps in the credit markets (including credit and store cards) would have unintended adverse consequences, distort competition and increase financial exclusion, particularly for low-income households.

— The Government should consider commissioning research to understand better which debt management tools are most effective for the various different categories of debtor.

Introduction

1. The Finance and Leasing Association (FLA) is the UK's leading trade association for the consumer credit, motor finance, and asset finance sectors. Our members include banks and building societies and their subsidiaries, the finance arms of leading retailers and manufacturing companies, and a range of independent firms.

2. In 2010, FLA members provided £72 billion of new finance to UK businesses and households. £52 billion of this was in the form of consumer credit, including 30% of all unsecured lending in the UK, made available via credit and store cards, unsecured loans, store credit, second charge mortgages, and funding for half of all private new car sales.

3. Credit supports the social and financial well-being of millions of consumers, who enjoy a higher standard of living through the access responsibly-provided credit gives them to essential goods such as furniture, electrical equipment, clothing and motor vehicles. The UK economy needs a healthy, vibrant credit market to support growth.

4. We are pleased to contribute to the Business, Innovation and Skills Committee's inquiry into the recent CCPIR by BIS. The FLA submitted detailed evidence to BIS in December 2010. The issues we raised remain valid:

— The Government should consider amending those provisions of the CCA which are no longer fit for purpose, or which gold-plate the CCD—in particular those clauses relating to Voluntary Terminations, Multiple Agreements and Modifying Agreements.

— Price caps on credit and store cards should not be introduced. All the available evidence shows that such caps are ineffective and do not work well either for borrowers or lenders.

— A robust case has not been made for introducing a cooling-off period for store cards, which would damage the markets and increase financial exclusion, as well as further gold-plate the CCD. Other ways can be found of addressing concerns about these markets.

— Work is needed to help customers navigate the huge variety of available debt management mechanisms, and make informed decisions about which would help them most.

5. We would be happy to give further evidence regarding any of the issues raised in this paper.

The Future of Consumer Credit Regulation

6. Our response to the BIS consultation made the case for a period of regulatory stability in the credit markets, following the very considerable changes of the last few years. Lenders implemented the Consumer

Credit Directive (CCD)—containing a wide range of new consumer rights—earlier this year. This was accompanied by the OFT's detailed new Irresponsible Lending Guidance and followed the radical revision of the Consumer Credit Act, which took effect in 2008. In addition, the industry has recently implemented a range of new market-specific measures, including new OFT Guidance for Secured Lenders, an extensive package of changes to credit and store card regulation, and a range of new ways of helping customers in difficulty, including a 30-day breathing space.

7. However well-intentioned, the large volume of new regulation has contributed to the recent contraction in the UK consumer credit market. New lending via credit cards in 2010 was 14% lower than in 2007. Other parts of the market have been hit harder. Particular problems have been seen in lending markets served by non-deposit-taking institutions, including the second-charge mortgage, store card and store instalment markets. Second charge mortgage new business dropped from £5.6 billion in 2007 to £294 million in 2010. Finance provided through store cards fell from almost £3 billion in 2007 to £2 billion in 2010. Several lenders have left the store instalment credit market altogether. These trends continue: store instalment credit has fallen by a further 11% in 2011, and store card finance by 15% over the same period. Only the motor consumer finance market has seen recent growth (3% since the beginning of 2011).

8. Against this background, the Government should allow time for the new consumer credit regulation to bed in, before considering any radical further changes. We have already mentioned the kind of evolutionary changes which could nonetheless be undertaken in the shorter term.

9. The Government has, nonetheless, separately proposed to transfer consumer credit regulation from the OFT to the new FCA, and at the same time to replace the existing CCA/CCD regime with an entirely new one based on the Financial Services and Markets Act (FSMA) which currently governs the deposit and savings markets. We have no particular problem with the transfer of regulatory responsibility *per se*. But we believe that credit regulation modelled on the current FSMA regime would risk a serious contraction of the consumer and small business credit markets, which are served by many non-bank lenders and are often highly intermediated. It is worth remembering that nearly 100,000 entities are currently licensed to provide credit in the UK, 40% of which are sole traders.

10. The FSMA regime is designed for markets where the primary risk lies with the depositor or saver. The opposite applies in the consumer and small business credit markets, where the risk lies with the lender. Features of an FSMA-style regime likely to cause problems include an Appointed Representative regime for the intermediary markets (around a third of consumer and small business lending is intermediated), regulation via Approved Persons, and new capital adequacy requirements, including for the non-banking sector. A considerable proportion of this market would be at significant risk from the unintended consequences of a FSMA-style regime of the kind currently proposed.

11. We have therefore suggested to the Government that it should make the transfer of regulatory responsibility under the current legislation, and then take the time needed for a proper assessment of the size and shape of any new regime. A careful and proportionate approach is needed to ensure that the market remains competitive and that consumers and small businesses can continue to access affordable credit. A sensible implementation period will also be essential, taking account (for example) of the European Commission's review of the CCD in 2013.

12. We have also argued that responsible self-regulation should continue to have an important part to play. The FLA is currently reviewing its Lending Code (established over 20 years ago) for re-launch early in 2012 to reflect recent regulatory and market changes. The Code allows FLA members in the lending markets to introduce new standards more quickly and efficiently than is usually possible via legislation.

Interest Rate Caps

13. We share the opposition to interest rate caps in the credit and store card markets expressed by most respondents to the BIS consultation. This was on the basis of the available evidence from overseas markets—and from the OFT's review in 2010—which showed that caps would restrict lenders' ability to price for risk and so increase the cost of credit to other consumers in the wider market. It would also increase financial exclusion, forcing borrowers on low incomes into the unregulated sector. The Government is undertaking some new research on the likely impact of a cap on the total cost of credit in the short-term lending markets. Whilst we have few members in these markets, we are concerned about the likely impact more generally of the introduction of caps on the price of credit, for the reasons outlined above.

Debt Management

14. Borrowers finding themselves in financial difficulty need to find the right sources of help. The FLA's members treat all cases of financial difficulty sympathetically and positively (one of the key commitments under our Lending Code), and we work closely with the free debt advice agencies to ensure customers in difficulty get quick and effective help. The industry provides most of the funding for the Consumer Credit Counselling Service. But the responses to the CCPIR showed that consumers often do not know whether or not they have been given the "right" advice, and are sometimes confused by the plethora of different debt management tools now available. The review also found that debtors in similar financial circumstances were sometimes given different advice depending on which organisation they approached.

15. It is clearly important to ensure that debtors receive the best advice for their individual circumstances. We have therefore suggested that the Government should undertake some further research into which debt management tools are most effective for different categories of debtor, and in which circumstances. This would provide a base of hard evidence for further policy decisions in this area.

14 November 2011

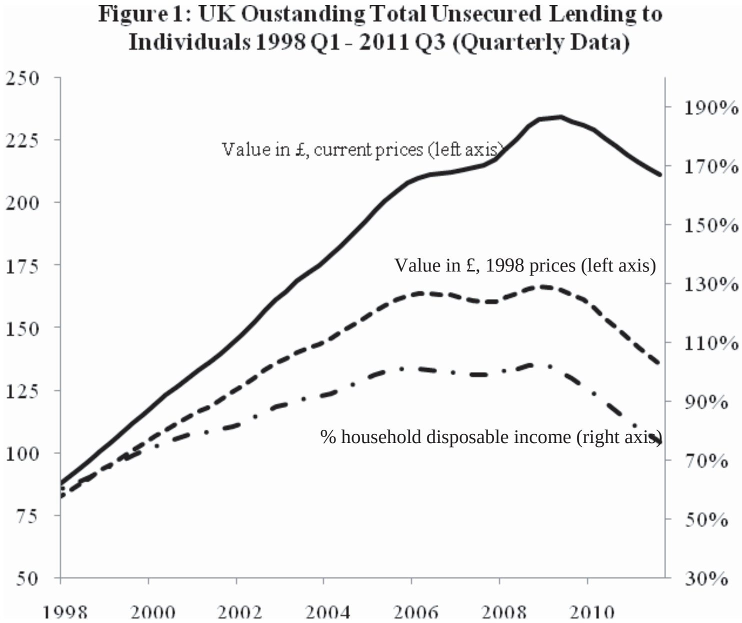
Supplementary written evidence submitted by Dr John Gathergood, University of Nottingham

1. This supplementary written evidence accompanies the oral evidence I presented to the Committee at the first evidence session on debt management on Tuesday 22 November 2011. At that session I undertook to provide the committee with additional statistics relating to personal insolvencies and household debt in the United Kingdom.

2. Turning first to the overall level of unsecured debt in the United Kingdom, Figure 1 below illustrates the evolution of the level of total outstanding unsecured lending to individuals since the beginning of 1998. At current prices the level of outstanding unsecured debt increased from £90 billion in 1998 to a peak of £240 billion in 2008, before beginning to fall back from early 2009 onwards.

3. Adjusting for inflation using 1998 constant prices, the value of total unsecured debt began to plateau in mid-2005 at approximately £160 billion. A similar pattern emerges when total unsecured debt is illustrated as a proportion of household income.

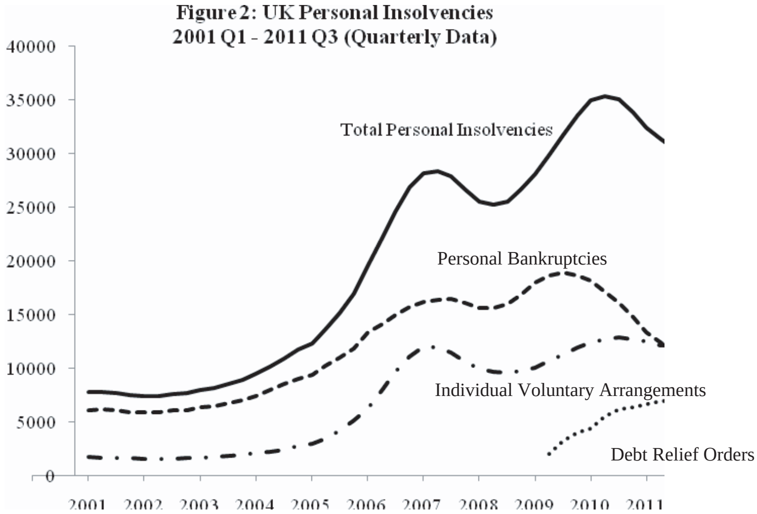
4. On this basis, mid-2005 can be seen as the peak of expansion of the UK unsecured debt market. Post-2005 the level of unsecured debt began to fall slightly before a small up-tick prior to the onset of the recession in 2008. Since early 2008 total unsecured debt as a proportion of household income has fallen from 100% to 70% by the third quarter of 2011.



5. Figure 2 below illustrates quarterly data for the total number of personal insolvencies originated since the beginning of 2001 plus a breakdown by the three types of personal insolvency in the UK.

6. From this figure, it can be seen that the total number of personal insolvencies each quarter was below 10,000 until mid-2004, after which the number of cases grew rapidly to over 25,000 per quarter by 2007. It is notable that the increase in overall numbers comprises both increases in personal bankruptcies and IVAs, so is unlikely to be explained by the change in personal bankruptcy law which took effect in 2004.

7. The number of personal insolvencies fell slightly after 2007 before rising sharply since the onset of the recession and peaking in early 2010 at 35,000 per quarter, only in small part attributable to the introduction of Debt Relief Orders in early 2009. There has subsequently been a sharp decline in the number of bankruptcies originated per quarter which has caused the total number of personal insolvencies to fall by 6,000 per quarter.



8. The distribution of unsecured debt across the population is very uneven. The most comprehensive data on unsecured debt usage at the individual level are held by credit reference agencies which are not publicly available. The next best source of data is the Wealth and Assets Survey which surveys 70,000 UK individuals on their financial position every two years. The most recent release of the data covers the period 2006–08. A detailed analysis of this data is presented in ONS *Wealth in Great Britain*. For the purposes of this written evidence I provide some more up to date summary statistics from the quarterly YouGov Debt Track survey from the period 2010–11.

9. Approximately 75% of individuals in the UK population hold an unsecured credit product, such as a credit card, bank overdraft or personal loan. However, at any time only 40% of individuals have a positive outstanding balance. The other 35% hold a credit product without borrowing on it, such as holding a credit card but not using it for purchases or having the option of a bank overdraft but not using it.

10. Those who borrow on unsecured debt are typically adults aged in their late 20s to mid-30s. For example, 57% of 26 to 35 year olds borrow on unsecured debt, compared with 27% of over 55 year olds. Those who borrow are typically married, in work, have a spouse/partner who is in work and have children.

11. There is little difference in the proportions of men and women who hold unsecured debt, or in the levels of debt they hold. Women are slightly more likely to hold unsecured debt than men, but men who hold unsecured debt typically hold slightly more debt. There is, however, more variation between men and women in the types of unsecured debt held. Women are more likely to hold store cards (17% compared with 6%) and are more likely to hold mail order catalogue debt (13% compared with 4%).

12. Those with lower incomes who hold unsecured debt tend on average to hold the highest levels of unsecured debt relative to income. At the household level, those households in the bottom two quintiles of the income distribution who have unsecured debts typically hold unsecured debts equivalent to 30% of their annual household income. For households in the next two quintiles the equivalent value is 20%. For households in the top quintile the equivalent value is 14%.

13. Problem debt is also more prevalent among those households with lower incomes. In the bottom two quintiles of the income distribution 25% of households with unsecured debts are at least one month in arrears. For the next two quintiles the equivalent value is 14%. For households in the top quintile the equivalent value is 8%.

14. Among those individuals at least one month in arrears on unsecured debt (18% of those with outstanding unsecured debts) 23% have experienced a period of unemployment within the last year, 11% have become divorced within the last year, 8% have seen an increase in the number of dependent children in their care within the last year and 6% have begun an incapacity-related benefit claim within the past year.

15. Among those individuals at least one month in arrears on unsecured debt 25% are unable to perform a simple interest calculation (15% of £1,000). The equivalent proportion among those without unsecured debt arrears is 16%. Among those one month in arrears 55% do not understand compound interest and 70% do not correctly understand the term “minimum payment” on a credit card. The equivalent values among those without unsecured debt arrears are 44% and 50% respectively.

30 November 2011

Written evidence submitted by Mind

About Mind

Our vision is of a society that promotes and protects good mental health for all, and that treats people with experience of mental distress fairly, positively, and with respect.

The needs and experiences of people with mental distress drive our work and we make sure their voice is heard by those who influence change.

Our independence gives us the freedom to stand up and speak out on the real issues that affect daily lives.

We provide information and support, campaign to improve policy and attitudes and, in partnership with independent local Mind associations, develop local services.

We do all this to make it possible for people who experience mental distress to live full lives, and play their full part in society.

General Comments

1. Mind welcomes the opportunity to contribute to the Business, Innovation and Skill Committee inquiry. The ways in which people are encouraged, empowered or assisted to manage their borrowing and deal with their debts can play a vital role in how these issues impact on their mental health.

2. Access to credit and financial services is increasingly a core component of modern life and can actively enhance people's lives. The majority of people with mental health problems have the skills and ability to manage their finances. We do not want people with experience of mental distress to be excluded from accessing credit, however there is a need for adequate safeguards to protect people's finances when they are unwell.

3. Mind's campaign "In the red: debt and mental health" has been calling for improved creditor policy and practice towards debtors with mental health problems since 2008. Mind would caution against regarding mental health as a niche issue affecting only a small number of consumers who require separate, more sensitive treatment. Given the circular relationship between debt and mental health[61] and the common nature of mental health problems—which ranges from anxiety and depression through to more severe conditions like schizophrenia—this is very much a mainstream issue and creditors should ensure the way they treat *all* consumers will not trigger or exacerbate mental distress.

4. Measures to discourage irresponsible lending and borrowing and to make dealing with debt more manageable are important in terms of reducing the risk of people getting into debt that may be detrimental to their mental health, or getting into excessive debt as a result of their mental health.

Specific Areas of Concern

5. These comments cover many of the areas examined as part of the Government's consultation on Managing, Borrowing and Dealing with Debt (the Consumer Credit and Personal Insolvency Review) as well as some other key areas of concern.

6. *Mental capacity*

6.1 Earlier this year, Mind repeated the survey which informed our "In the red" report[62] Although the data from this survey have not yet been released, we believe it is important to flag up one area of results around mental capacity.[63]

6.2 Only about 50 people from almost 500 respondents to a question on this issue reported that creditors were aware of their mental health problem at the time of taking out credit, although our data do not indicate whether this is because the borrower told the creditor this, or whether the borrower felt their creditor had assumed this without it being said.

6.3 Very few respondents reported creditors asking questions about their mental health at the time of lending. Only 3% of all respondents reported creditors expressing concerns about their ability to manage the loan or credit as a result of their mental health problem(s).

6.4 However, this lack of awareness, enquiry and concern about the mental health of applicants for credit was not reflective of how respondents felt their mental health impacted on their ability to make an informed decision about borrowing. This was an even greater issue for those respondents in problem debt, as might be expected.

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[61] Being in debt can negatively affect a person's mental health, while living with a mental health problem increases the likelihood of falling into debt. From Mind (2008) In the red: debt and mental health.

[62] The survey was developed in partnership with the Royal College of Psychiatrists and administered online and offline and targeted at people with experience of mental health and debt problems. Data for the original survey was collected during December 2007 and January 2008, and for the second survey during February and March 2011.

[63] We would be willing to share the complete survey data with the committee if requested.

6.5 Three in ten respondents said they were not able to make a reasonable decision about whether to take out the loan or not. This increased to four in ten among respondents in problem debt (defined as being two or more consecutive payments behind with a bill).

6.6 A quarter of all respondents said they were not able to understand the terms and conditions of the loan. Among respondents in problem debt, this figure increased to a third.

6.7 Over a third of all respondents and almost half of those in problem debt reported not being able to ask questions or discuss the loan with their potential creditor.

6.8 While none of the above statements give a definitive indication of an individual's mental capacity to take out credit, mental capacity is certainly a pertinent concern flowing from these findings on individuals' self-reported ability to make an informed decision about borrowing. The Office of Fair Trading has recently published draft guidance to creditors on mental capacity and irresponsible lending. This guidance tells creditors what to do if they might reasonably suspect a prospective borrower lacks the capacity to borrow.

6.9 Importantly, it is not simply a case that creditors should withhold credit from anybody who has difficulties understanding the terms of the credit they wish to take out. Rather, creditors are expected to provide support to anybody experiencing such difficulties, so that they acquire the capacity to make a reasonable decision. If an individual then still appears to lack capacity, the creditor is expected to ascertain whether this is the case.

6.10 Given this regulation, the above survey data suggest that there is much for creditors to do in terms of supporting customers—including but not limited to those with mental health problems—who may not have the capacity to make an informed, reasonable decision about whether to take out credit. A key part of this process is ensuring that adequate explanation of the terms of credit are provided, taking into account the difficulties that the customer may face in understanding these.

7. *Advertising of credit*

7.1 Mind would support moves to ensure that advertising of credit makes clear the risks of taking on debt. People may well get into debt as a result of a mental health issue, for example when seeking relief from low moods by spending, or as a result of disinhibited spending during a manic phase of their bipolar disorder. As such, it is important that credit is not advertised as an "easy option" for those facing complex or difficult circumstances.

7.2 Many people have reported to Mind that their problems with debt started because it was simply too easy to find credit. It was often the case that people were not even looking to borrow money but they were enticed into borrowing through advertising which presented credit as being highly accessible to anyone. Irresponsible borrowing could not happen without irresponsible lending.

7.3 *"Apart from a couple of the bank loans all the debt came though the post, you know 'Apply today for our credit card'. So I did. I didn't go out and actively seek the credit, it was just too easy to fill out the form and then post it."*

8. *Information on credit*

8.1 Mind would welcome steps to ensure that consumers have access to as much information as possible about potential sources of credit, particularly when those available to them are not mainstream sources. Our research suggests that people with mental health problems can be particularly vulnerable to high cost lenders, often because these sources of credit seem most accessible rather than because they are necessarily the only available options. As discussed above, people will often just take credit that is offered to them, without knowing whether the terms and rates that they are taking on represent a fair and competitive deal.

8.2 The option to directly compare creditors would allow consumers to make a more informed decision which should help them avoid getting into debt that will be detrimental to their mental health or taking on damaging debt as a result of impairment caused by their mental health problems.

9. *Code of practice for lenders*

9.1 Mind would welcome a code of practice for home credit suppliers, payday lenders and pawnbrokers and would be keen that it included reference for dealing with customers with mental health problems in terms of avoiding causing problem debt for such customers; knowing how to deal with disclosure of mental health problems by indebted customers; and having appropriate policies in place to recognise the additional difficulties those with mental health problems may have in accumulating and paying back debts.

9.2 We would suggest that any such code of practice was in line with the Money Advice Liaison Group's guidance on debt and mental health;[64] and the Royal College of Psychiatrists' research into debt collection and mental health.[65]

[64] "Good Practice Awareness Guidelines For Consumers with Mental Health Problems and Debt" http://www.malg.org.uk/documents/MentalHealthGuidelinesEd2Final2009.pdf

[65] "Debt collection and Mental Health: ten steps to improve recovery" http://www.rcpsych.ac.uk/pdf/Debt%20collection%20and%20mental%20health%20-%20ten%20steps%20to%20improve%20recovery%20(10_11_17).pdf

9.3 We would also be keen that that any such code of practice was enforceable and that meaningful action could be taken against lenders/creditors/pawnbrokers who contravened it.

10. *Sharing of data*

10.1 We recognise that many people with mental health problems have debt difficulties relating to utility companies and local authorities. We believe that the way in which these problems are managed by these companies and authorities could be vastly improved. However, we would be wary about the sharing of information regarding a customer's mental health between companies, organisations and bodies due to the negative impact that this could have on the customer's ability to secure credit and other services. Any such sharing would need to involve the customers consent and full explanation of what the implications might be for the customer.

11. *Penalty charges and interest*

11.1 Many people have reported to us that debt can become hard to manage due to factors such as penalty charges and excessive interest. Such measures by creditors can make it virtually impossible for people to manage their debt, which in turn can lead to the triggering or exacerbating of a mental health problem. This scenario is often described as a "debt spiral".

11.2 *"Several companies have been quite obstructive and obviously delayed dealing with our communications to heap on charges and higher interest to our outstanding debt to recoup the 'interest and charges free' period of repayment plans in advance. It has been an extremely stressful time—there have been several times when we have questioned whether it has been worth carrying on."*

11.3 We would welcome the introduction of measures to both limit such charges and interest, and require banks and other creditors to respond quickly and effectively when it is clear that someone's debt has become problematic as a result of such factors. Since this is not simply and issue with mainstream creditors, we would also be keen to see credit caps for all forms of credit and not just for credit and store cards.

12. *Regulating bailiffs*

12.1 Mind has been calling for effective regulation of bailiffs since our "In the red" report in 2008. Our report suggested that bailiffs can cause immense distress to people in debt, often through behaviour that is illegal or in breach of industry codes but there is insufficient regulation to challenge such behaviour.

12.2 *"An analysis of 500 case reports from Citizens Advice Bureaux in England and Wales found that 64% of bailiffs were felt to have been exhibiting behaviour of harassment or intimidation, 40% misrepresented their powers of entry, 25% threatened debtors with imprisonment and 42% charged excessive fees."*[66]

12.3 We also carried out some additional research on people's experience of dealing with bailiffs which yielded more than 450 responses.[67] Below is a summary of the findings.

Bailiffs' behaviour

12.4 Respondents reported inappropriate, heavy-handed and in some cases unlawful behaviour by bailiffs, including:

— Threatening behaviour such as intimidating children while the debtor was not at home.
— Forcing their way into debtors' homes.
— Almost a third of respondents had been threatened with prison.
— Being dismissive when people tried to disclose mental health problems.
— Being reluctant to discuss options for repaying the debt with the debtor.

12.5 A mere 10% of debtors felt bailiffs listened to them, while almost 80% felt bailiffs exhibited threatening behaviour.

Impact on mental health

12.6 Overall, 94% of respondents said contact with bailiffs had a negative impact on their mental health. When asked about what kind of impact this had:

— 95% reported an increased level of anxiety;
— 63% felt less able to manage their mental health;
— 87% reported increased levels of depression; and
— 50% experienced suicidal feelings.

[66] "In the red: debt and mental health", 2008, Mind.
[67] This research involved an online survey of people with experience of mental health problems and contact with bailiffs. Data was collected during December 2009 and January 2010.

12.7 We would be in favour of regulatory powers with genuine capacity for discouraging such behaviour and effectively challenging it where it occurs. Efforts to regulate this industry should also involve limiting current powers allowing bailiffs to force entry into a debtor's property and to tackle where bailiffs are misusing their powers or misrepresenting the legitimate scope of their powers. We also encourage the Government to work with Mind to ensure regulation is appropriate to the needs of people with mental health problems give our findings.

12.8 Specifically, we believe any regulation needs to include:

A fair and proportionate fees structure, which does not penalise people with mental health problems who may be unable to engage with the earlier stages of debt recovery due to their condition, rather than unwillingness, but therefore automatically fall into higher fee bands.

Mental health awareness training as a licensing requirement for all enforcement agents, to equip them with the necessary awareness and skills to ensure debt recovery tactics do not worsen debtors' mental health (and ultimately make recovery more unlikely)

Revised National Standards for Enforcement Agents which explicitly address the links between debt and mental health and the responsibility of enforcement agents not to cause harm to the public—including causing further mental distress

A referral mechanism for vulnerable debtors, so enforcement agents can pass debts back to creditors where debt recovery by bailiffs is inappropriate—but without enforcement agents being penalised by losing their anticipated collection fees

Clear and easily accessible information on the rules—those who come into contact with enforcement agents are entitled to know their rights and how they can complain if these rights are breached

An industry-wide code of practice and complaints procedure, which is sufficiently robust to improve practice throughout the industry, and is fully accessible to people with mental health problems to enable people to report poor practice

13. *Debt advice*

13.1 For debtors with mental health problems, it is important that advice and support is carefully targeted so that they are aware both that such support and advice is available and would be of help to them, and where they can find it. We have suggested providing more access to debt advice and support within primary healthcare settings but we would also welcome more emphasis from banks and other creditors on targeting support at vulnerable customers.

13.2 Debtors with mental health problems need to feel that their circumstances will be recognised and by creditors and that advice and support will help them to manage their debt more effectively. Ideally, certified sources of advice and support would have adequate profile for most people to be aware of the services on offer. This would also help ensure that debtors are getting the "right" advice.

14. *Temporary relief*

14.1 We would greatly welcome the opportunity for people to receive temporary relief from creditors when they get into difficulties, either because of deterioration in their condition or because of some kind of income "shock". Often, as a result of creditor action or an unexpected expense, people's debt can snowball and this can be hugely damaging for their mental health. Such scenarios can lead to people feeling that things are out of control which can cause significant anxiety and could trigger more severe mental health problems.

14.2 Having the time to understand their circumstances and seek appropriate advice and support at times of difficulty could help to prevent people's debt becoming a serious problem, which could help avoid repercussions in terms of mental health problems.

Supporting Information

Relevant findings from Mind's "In the red" report (2008)

Creditors often threaten or use legal action to put pressure on those in debt. Mind found that of those respondents who had missed two or more consecutive payments:

— 78% had been threatened with legal or court action;

— 51% had been contacted by bailiffs or debt collectors; and

— 25% had received a County Court Judgement.

Mind's report shows that for many respondents who had slipped into problem debt, the fear of legal action against them had a significant and negative impact on their mental health. However, more than two thirds of people did not tell creditors about their mental health problems, because they feared they would not be believed, understood, or because it would not make any difference to how their debt was handled. Our findings show these fears are not unfounded—of those who did disclose their mental health problems:

— 83% were still harassed by creditors;

— 79% felt their mental health problems were not taken into account when a decision was made about their financial difficulties; and

— 74% felt they were treated unsympathetically and insensitively by staff.

"The worry of the debts and not being able to pay bills just makes everything seem worse and you feel as if things will never change and you will never be able to pay or catch up with arrears. When you receive threatening letters for possession or to be taken to court or even with bailiffs, it makes everything bleaker. And suicide becomes more inviting the more the letters arrive."

Relevant Recommendations from Mind's "In the Red" Report (2008)

Better regulation of doorstep lenders and private finance companies

Mind calls on the Office of Fair Trading (OFT), under the new provisions of the Consumer Credit Act 2006, to set out a rigorous process for gathering information on lenders' compliance with legislation and guidance and to take steps to ensure companies address any poor practice. At the moment identification of poor practice is over-reliant on consumer complaints.

In addition, the OFT licensing conditions should require lenders to show evidence of mental health awareness training.

Better regulation of bailiffs

The Ministry of Justice has developed guidance on this issue for enforcement officers but it is not enough. The Government needs to build on the enactment of the new Tribunals, Courts and Enforcement Act 2007 by regulating bailiffs to ensure effective safeguards for people with mental health problems.

County Court Bailiffs are bound by the public authority Disability Discrimination Act (DDA) duty to have due regard to disability issues, including those pertinent to people with mental health conditions. The statutory guidance that accompanies the DDA suggests the following as ways to fulfil this duty:

— taking steps to take account of a disabled person's disabilities, where that involves treating disabled people more favourably than other persons;

— elimination of harassment of disabled people that relates to their disability; and

— promotion of positive attitudes towards disabled people.

Mind urges all statutory agencies that use bailiffs to include disability equality duty specifications in their procurement contracts.

Improved access to affordable sources of credit

Mind calls for better promotion of, and accessibility to, the affordable sources of credit open to people with experience of mental distress.

Mind calls for the following developments and changes to enable the credit union movement to increase capacity and coverage to make their services easily accessible to people with experience of mental distress:

— Legislation allowing credit unions to reach out to new areas and make the most of partnerships with housing associations and employers, increasing access to credit union services.

— Local authorities and other community organisations to assist credit unions in increasing accessibility and credibility by helping with accommodation, developing partnerships and, where possible, providing funding to support the development of credit unions.

— Community organisations and private sector organisations such as banks and major employers to assist by seconding staff to credit unions, mentoring and participating in governance.

Customers with mental health problems should be able to ask their bank to flag their current account and monitor it for unusual spending patterns

Mind calls for banks to allow customers to put flags on their current accounts to question erratic spending in specified time periods. Mind would like to see this adopted as common practice for people who would like to protect their finances when they are unwell and may be at risk of making unwise financial decisions.

Mind also calls for a safeguard system whereby customers either have to give a predetermined period of notice or joint authorisation from a designated friend or support worker before a flag can be removed from their account.

Banks to respond appropriately to missed payments by customers with mental health problems

Mind calls for banks to have procedures in place to respond appropriately to customers who have disclosed their mental health problems and have missed payments.

If a customer has been unwell and unable to manage their finances then the banks should waive penalties for missed payments. The missed payment should be viewed as an indicator that the customer is experiencing difficulty and the case should be referred to a specialist mental health team within the bank. If the bank lacks resources for this, there should be a sufficient level of training for staff to ensure they can deal appropriately with customers with mental health problems.

Adherence to the new Money Advice Liaison Group's good practice guidelines

Mind calls for all organisations within the financial industry to adopt and build the good practice guidelines into their policies and procedures. Organisations should also commit to reviewing how well the guidelines have been implemented.

The MALG guidelines on debt and mental health represent the first ever detailed UK recommendations on what creditors should do when a person has debt and mental health problems. These guidelines aim to supplement existing industry codes for banking, leasing, and credit service organisations. The Money Advice Liaison Group is a non-policy making body, so cannot impose the guidelines on the creditor sector. The review of the Lending Code offers an opportunity to enshrine the MALG guidelines in an enforceable Code.

Creditors should have procedures in place to ensure that people with mental health problems who are in debt are treated fairly and appropriately

Mind calls for all creditors to have procedures in place that ensure people with mental health problems who are in debt are treated fairly and appropriately.

Collection action by creditors should be proportionate to all the circumstances, including customers' likely longer-term ability to repay. Creditors should consider writing off unsecured debts when mental health problems are long term, hold out little likelihood of improvement and make it unlikely that the debtor will be able to repay outstanding debts.

Creditors that outsource debt should ensure that third parties comply with the MALG Guidelines and relevant codes of practice. Creditors should only pursue enforcement through the courts as a last resort and when appropriate.

Creditors should consider writing off debts where a person's mental health means they did not have capacity to contract. Currently the law states that a contract is void where the other party (the lender) was aware of the incapacity. However, in Scotland debts can be struck off where there is incapacity without the other party having notice. Mind welcomes the Office of Fair Trading's ongoing work around mental capacity.

Creditors should also establish whether the mental health problem will affect a customer's ability to deal with telephone, written or face-to-face communication.

Where a creditor has been notified of a mental health problem they should allow a reasonable period for relevant evidence regarding the influence of mental health problems on a customers' ability to manage their debt.

The collection of appropriate evidence on how a person's mental health problems affect their ability to manage or repay their debt should be undertaken using a common form that all parties—creditors, money advisers, health professionals and people with personal experience of debt and mental distress—recognise. MALG has developed the Debt and Mental Health Evidence Form to meet this need.

Specialist mental health training for bank, debt-collection agency and debt purchasing company staff

Mind calls for banks, debt-collection agencies and debt-purchasing companies to ensure a basic general standard of relevant mental health awareness training across the staff cohort.

The advisers within the specialist debt-collection units at Royal Bank of Scotland receive mental health awareness training and use this to work more effectively with the customer who is experiencing problem debt. This good practice should be adopted across the sector.

If it becomes clear that because of a person's mental health problem standard processes are not appropriate, the person should be referred to a specialist team within the organisation trained to help customers with more complex issues. The cost benefit of specialist teams may well work in organisations' favour, as such teams would have the skills and experience to process cases more efficiently and effectively. If organisations are unable to support a specialist team they should ensure that members of staff who have relevant training are able to assist customers.

Energy and water companies to improve their service to people with mental health problems

Mind calls for energy and water companies to provide a better service to people with mental health problems—one which is more flexible and responsive to the needs of the individual. Energy and water companies currently offer a number of services for disadvantaged customers. This usually involves the customer being placed on a Priority Services or Vulnerable Customers register, which ensures that the person can speak to the same contact every time. They may also be entitled to a reduction in charges if they are in receipt of certain benefits, they can ask for help understanding bills and they can apply for money from the company's hardship fund.

Advisers who are able to provide information about debt and welfare benefits to be based at GP surgeries

Mind calls for primary care trusts (PCTs) in England and local health boards (LHBs) in Wales to further commit to funding debt and welfare advice services in primary healthcare settings. Some advice is already delivered in such settings but provision is patchy.

Improved access to money and debt advice services

Mind calls for banks to work with the Government to improve access to independent debt advice services for people with mental health problems.

Mind welcomes the initiative by the Government to produce a framework for delivery of a generic financial advice service for the United Kingdom. Mind also acknowledges that banks already provide funding to support debt advice and related activities but calls for banks to contribute more through the disbursement of their corporate social responsibility funds.

Existing and future debt advice services need to be better targeted at people with mental health problems and services need to take account of the gaps in provision raised in this report.

10 November 2011

Written evidence submitted by the Money Advice Service

About Us

1. The Money Advice Service is a nationwide service that helps consumers understand financial matters and manage their money better. We provide information and advice online, over the telephone and face-to-face. We were set up by Government and are funded by a levy on financial services companies regulated by the Financial Services Authority.

2. Our statutory function is to enhance the understanding and knowledge of members of the public about financial matters (including the UK financial system), and their ability to manage their own financial affairs. This includes providing information and advice to members of the public to help them understand money matters better and take control of their money.

Summary

3. In addition to our current role, from April 2012 the Money Advice Service will be responsible for the coordination of debt advice provision across the UK. We announced this in July this year following the publication of the Government's response to the insolvency aspects of the Consumer Credit and Personal Insolvency Review.

4. Our role in this area is two-fold:

— To develop a model of debt advice delivery that is as efficient and effective as possible.

— To ensure continuity of service delivery during a transitional period while our delivery model is developed and implemented.

5. We will aim, over the next two years, to expand the reach of and bring greater consistency to the debt advice landscape. We expect to be in a position to put in place a final model of debt advice delivery by the end of 2013.

6. This new role provides us with the opportunity, over time, to align the provision of debt advice with our existing money advice services, and to help consumers with their money issues before debts become unmanageable.

7. Our current priority is to ensure that high-quality debt advice continues to be available. We will work to raise the profile of the free-to-client advice sector and fund services as appropriate.

8. Subject to receiving funding from the Financial Services Authority (FSA), in 2012–13 we will fund a series of face-to-face debt advice projects across England and Wales that were previously managed by the Department for Business, Innovation and Skills and funded by the Department and the Financial Inclusion Fund.

9. In Scotland and Northern Ireland, we are working closely with the devolved administrations to fund services next year in each country that recognise the particular differences in the debt resolution environment in those countries.

10. We believe that debt advice should be available across all delivery channels but that self-help approaches should be emphasised with as many people as possible accessing self-help resources digitally.

11. We believe that face-to-face advice should be available for clients with particularly complex debt problems and those who are unable to access other channels.

12. Over time, we will integrate our work on crisis debt advice with our existing preventive work to build consumers' financial resilience.

13. We work closely with the advice sector, creditors and regulators and will continue to do so. Our business plan and budget for 2012–13 is currently out for consultation.

Introduction

14. In July this year we announced that from April 2012 the Money Advice Service will be responsible for the coordination of debt advice provision across the UK.

15. The announcement followed the Government's response to the Consumer Credit and Personal Insolvency Review which stated that we are well placed to take a role in coordination of debt advice services, and to develop a model which ensures that debt advice outcomes can be delivered in an effective, efficient way.

16. The NAO called for greater consistency and efficiency in their report into the previous Government's over-indebtedness strategy in 2010 and our engagement with a wide group of stakeholders across the advice and creditor sectors has validated the mandate for change we have been given. This is especially important in an environment where there is a widely held expectation that the demand for debt advice will increase in the medium term.

17. We welcome the Government's move to clarify our role to include the coordination of debt advice. Our vision is that people with unmanageable debt know where and how to access an effective debt advice service that delivers consistent and fair outcomes for them and their creditors.

18. The new role of coordinating debt advice from April 2012 complements the existing remit of the Money Advice Service, which is to offer free, unbiased money advice to help everyone make the most of their money as a matter of course.

19. Over the last year the Money Advice Service has reviewed its range of products and services and is now looking to enhance its service to consumers, making sure that it delivers more, to an even greater number of people. We will continue to offer everyone access to this service through a national network—over the telephone, face-to-face and through digital channels. Our initial debt advice work has been undertaken in parallel to this review and its integration into an holistic Money Advice Service, in due course, should allow us to provide a more efficient, comprehensive and seamless service for people regardless of their position.

20. We already provide a range of tools, information and advice about borrowing and signpost people to the free-to-client debt advice sector as appropriate. We have also had early discussions with BIS about how we can work with them and the financial services industry to promote our service to encourage people to make informed decisions about borrowing.

21. We will continue to promote the free-to-client debt advice sector and as our organisation builds its profile over coming years we expect to increase consumer awareness of the scope of that sector, particularly services available digitally and on the telephone.

Plans For 2012–13

22. Our priority is to ensure resources are available from April 2012, so that people continue to have access to quality debt advice.

23. During 2012–13 we will work with all stakeholders to develop a model of debt advice coordination that builds on the extensive good practice that currently exists with the aim of ensuring that the demand for debt advice can be met in the most efficient and effective way.

24. In England and Wales we intend to take over responsibility for the Department for Business, Innovation and Skills' face-to-face debt advice projects from April next year.

25. We are working closely with stakeholders in Scotland and Northern Ireland—including the Scottish Government and Northern Ireland Executive—to ensure work we intend to fund in those countries is appropriate for their debt resolution environments and is as effective as possible.

26. We are working closely with each of the projects that deliver debt advice services for BIS and are being careful to communicate clearly to them the steps we are taking to ensure continuity.

27. We expect to receive confirmation of our budget for 2012–13 from the FSA in early December. The budget we have presented includes a request for sufficient funds to ensure continuity of face-to-face service delivery while our work with the projects is focussed on helping them support a greater number of people than the 100,000 they currently advise across England and Wales each year. In the context of planned Legal Aid scope changes, we will work with the projects to increase their reach to at least 150,000 people while maintaining a high quality service.

COORDINATION

28. The final scope of our coordination role will emerge from the detailed development work we have begun and will continue over the coming year. Initial discussions with stakeholders indicate there are a number of key principles however that will be important when designing our operating model:

- There should be a single set of agreed outcomes for debt advice—on the basis of which delivery and evaluation should take place.
- People should know where, when and how to access the right debt advice for them.
- There should be a standard set of "approved" tools that are well used and well understood by advisers, creditors and consumers.
- Consistent responses should be made to similar presenting concerns across the UK, legislation permitting, and as much as possible there should be consistency in consumer experience.
- Standardised data collection should allow for better measurement of impact, improved learning and more accurate targeting of resources.
- Digital self-help should be the default option for advice. If that is not suitable for an individual then they should be encouraged to access telephone advice.
- Face to face advice should be available for service users who have particularly complex debts or have accessibility issues with other channels.
- Referrals between channels should be appropriately incentivised in any contract arrangements.
- The targeting of resources for face-to-face advice should be based on demographic and issue-specific factors built into a triage mechanism.

29. We expect to be in a position to put in place a final model of coordination by the end of 2013.

RESEARCH

30. We are approaching the end of an extensive programme of research, funded by BIS. This includes a survey of the landscape of advice provision, an assessment of the needs of over-indebted consumers, extensive consultation with creditors, the advice sector and public bodies across the UK and the development of a model for the allocation of funding for debt advice.

31. We will publish the results of our research when the programme of work is complete.

FUNDING

32. It is Government policy that the financial services industry should pay for debt advice in the future. To help us determine a sustainable funding source for debt advice, we have commissioned research analysing what organisations contribute towards over-indebtedness and what model could be implemented to collect funds efficiently. For 2012–13 it is expected that funding will come exclusively from the FSA levy.

33. We are mindful of existing industry funding for debt advice, particularly the "fair share"[68] model and it is not our intention to displace that funding. The projects we intend to fund next year will not duplicate the service provided by "fair share" funded organisations and we will work with organisations we fund to ensure that the clients they support need to access advice face-to-face and are unable to use other channels.

15 November 2011

Written evidence submitted by the Money Advice Trust

1. The Money Advice Trust (MAT) is a national charity founded to help people across the UK tackle their debts and manage their money wisely. MAT's frontline services include the provision of debt advice (to 150,000 individuals and 30,000 small businesses via National Debtline and Business Debtline respectively). We also train free-to-client debt advisers across the country and develop products (such as the Common Financial Statement) to improve the credit and debt environment. We are on track to support 1,356,000 people in 2011.[69]

1.1 MAT sits at the heart of money advice in the UK. Our Partnership Board and grants programmes enable us to gather intelligence from other national advice providers, government departments, major creditors and local charities. MAT also conducts an annual research programme which seeks to develop understanding around causes of and behaviours in relation to problem debt. Publications in the past year have looked at the key macro-economic drivers of demand for debt advice, gendered behaviours around dealing with problem debt,

[68] The "fair share" model is a voluntary payment arrangement agreed between some creditors and some free-to-client debt advice organisations. An agreed sum is paid by the creditor each time a payment is received from a client whose debts are being managed by the advice organisation. The payment is not deducted from the amount paid by the client. Fair share payments make up the bulk of the funding currently provided by the financial services sector to the debt advice sector.

[69] Money Advice Trust Impact Report, http://www.moneyadvicetrust.org/images/Impact%20Report%20Final%20Draft.pdf

the case for early identification of debt problems and supportive intervention by creditors and the ongoing impact of the recession on low and middle income families in relation to their use of credit[70].

Consumer Debt

2. MAT notes that the Select Committee has requested evidence around the general area of consumer debt. MAT's recent research (see Appendix A) has identified the following trends. Firstly, that the key drivers in demand for debt advice (and thus of debt in the initial instance) are: rising cost of credit, stagnating wage growth and rising unemployment. Recent qualitative research has confirmed that many families are only managing due to low interest rates. Secondly, that demand for debt advice is greatly outstripped by unrecognised need: at any time, approximately 5 million people display indicators of problem debt, of whom only one in six seek advice from any source[71].

2.1 Thirdly, both qualitative and quantitative research indicated that consumer debt becomes problem debt usually through life events unforeseen by the consumer when credit arrangements were taken out (such as job loss or relationship breakdown). This is particularly true when two such life events occur within a short period of time.[72]

2.2 This research is worth considering in this context because it highlights the extent to which problem debt is often beyond the consumer's foresight or control, particularly in the current economic climate. Clear solutions, which cover the different types of consumers (from low to high levels of debt, assets and income) and provide clear protections (such as freezing of interest and charges) support people back into financial health.

2.3 Research published by the Money Advice Trust in early 2011 on gender differences and advice seeking did not explore differences between men and women getting into debt, but did suggest that men are less likely to seek advice.[73]

2.4 MAT has insight into the overlap between business and consumer debt through its provision of advice to small businesses via Business Debtline (BDL). Since 2009, the number of business owners calling the helpline citing use of personal credit has doubled. The reasons behind this have not yet been thoroughly investigated, but anecdotal evidence from callers and from our advisers suggests that restriction in the availability of business credit is a factor. Some of this restriction may be perceived rather than actual: for example, business owners may be choosing to use personal credit over business credit due to media coverage on small business lending and fears around footprints of rejected applications on credit files. MAT is exploring research proposals around this for 2012.

Support Mechanisms for People in Debt

3. In MAT's opinion, the BIS response to the consultation did not go far enough in providing options for individuals in debt. The existing series of options is complicated[74] but at the same time some people fall through the gaps between appropriate remedies.

3.1 MAT would advocate the Select Committee looking at the ways in which the Debt Arrangement Scheme works in Scotland and also considering the possibility of statutory debt management plans, as outlined in the initial consultation paper. Elements of these would provide more protection for people who fall though the gaps in the current system—in particular, a moratorium on interest payments, no lower limit on surplus income available and payment to creditors via an approved payment distributor.

3.2 MAT welcomes the acknowledgement in the consultation response that "Some commercial [debt management] providers steered individuals towards solutions that were aimed more at generating income for the provider than providing the best solution for the debtor" and the announcement that a debt management protocol will be established to work alongside the OFT Debt Management Guidance. However, we have a concern if this protocol were to be voluntary—as the IVA Protocol currently is—since there is no compulsion on companies only to offer compliant products. We therefore do not believe that on its own this could drive out rogue elements in the debt management industry; it is worth remembering that when the OFT investigated this sector in Autumn 2010 they found over 90% non compliance with their guidelines across the industry. We support the OFT's attempts to raise standards within this sector but continue to have concerns about widespread poor practice.

3.3 MAT welcomes the announcement in the BIS consultation response that all lenders should direct customers experiencing problems to a source of reputable debt advice and points to its research regarding effective early intervention by creditors[75]. However, this research also highlighted some considerations around effective customer referral: the organisation or channel (face-to-face, telephone or internet) needs to be appropriate to the customer's needs and the reasons for referral must be made clear to the customer, so that they do not feel "abandoned" by their lender at a point of vulnerability. We believe that the additional measures

[70] A list of relevant MAT research reports, with links to web-based copies is available in Annex A.
[71] Demand, capacity and need for money advice. Gathergood, 2011. Appendix A.
[72] Facing The Squeeze, Collard 2011, Appendix A.
[73] Seeking Direction, Goode, 2011 Appendix A.
[74] See "Strategies for dealing with debt", MAT—Appendix B.
[75] Understanding Financial Difficulty, Collard, 2011. Appendix A.

which would help would be: a national kitemark for reputable advice sources, tailored referrals to specific sources of advice depending on the customer's needs and clear explanations in plain English on the reasons for and benefits of referral. Early findings from research into the different channels for debt advice, commissioned from MAT and being undertaken by Policis indicate that clients of telephone, face-to-face and internet advice tend to be equally satisfied where the service is appropriate to their need.

3.4 MAT understands that the £27 million Financial Inclusion Fund previously run by BIS for provision of face-to-face advice in England and Wales will now be administered by the new Money Advice Service (and possibly extended to Scotland and Northern Ireland) and funded by a levy raised on the financial services industry. It is important to note that this £27 million does not cover anything like the entirety of debt advice services provided via a range of channels in the four administrations of the UK and funded largely by central and local government. Independent research conducted last year by the Friends Provident Foundation estimated this to be in the region of £106–£109 million per annum. Additionally, financial services and other consumer lenders currently provide funding directly to charities in the sector, either through donations (as in the case of the Money Advice Trust[76]) or via a "Fair Shares Contribution"[77] as in the case of the Consumer Credit Counselling Service. The Committee should be aware that beyond funding the face to face services, the Money Advice Service plans to co-ordinate debt advice across the UK from approximately the end of 2013. In the transition between April 2012 and this point debt services will continue to need funding, at a time of significant need and when our forecasting predicts rising demand for debt services. Without adequate transition arrangements, many individuals will be unable to access advice and may turn to fee-charging debt management companies or simply ignore the problem until it becomes much more severe and can only be resolved by more drastic and expensive solutions such as bankruptcy.

3.5 In addition, it is worth noting that a broader range of creditors than those who will be paying the Financial Services Authority's/Money Advice Service's levy benefit from debt advice. We have suggested both to the Money Advice Service and to the FSA—soon to be the Financial Conduct Authority—that they should consider extending their levy to cover this wider set of creditors.

3.6 The Committee will be aware that changes to legal aid provision mean this will not be available to those in debt, except where repossession is imminent. We expect this to start to have an impact on the variety of sources to which we can refer clients in need of specialist legal support.

3.7 MAT supports financial education as a means, over time, of preventing some debt problems and empowering consumers. In our experience, provision of debt advice provides an ideal "touchpoint" to improve financial knowledge and capability more broadly because the individual is actively engaged with the topic. National Debtline already provides some elements of this, for example by supporting people to create and maintain personal budgets. This has a strong positive impact: more than 86% surveyed as part of our 2010 longitudinal service evaluation indicated increased knowledge and confidence about managing money.

Recommendations

4. The Money Advice Trust's recommendations for the Select Committee are as follows:

- Consider how best to share best practice amongst creditors around early intervention for customers showing signs of financial stress, and effective signposting and referral to reputable sources of debt advice.
- Consider introduction of a national kitemark for reputable debt advice.
- Appreciate that different channels for debt advice (face-to-face, telephone and internet) serve the needs of different types of clients. Better understanding of the evidence here could ensure that customers access in good time a channel they can use effectively, thereby preserving more expensive face-to-face services for those who really need them.
- Discuss as priority with those responsible how debt advice services beyond those previously falling under the Financial Inclusion Fund will be supported and funded between April 2012 and end 2013.
- Consider introduction of aspects of Debt Arrangement Scheme or aspects of statutory debt management plans to a) provide clear protections for all consumers and b) ensure no consumers fall between gaps of appropriate debt solutions.
- Consider requirements for fee charging debt management companies to make clear in advertising and at first contact that independent, free-to-client alternatives from non-profit providers are also available, as outlined in the Private Member's Bill presented by Yvonne Fovargue MP (which received cross-party support) on 19 October 2011.
- Consider how to most effectively raise standards within the fee-charging debt management sector.

[76] MAT's funding in 2011 comes in the following way: approximately 60% from private sector donations, approximately 30% from Government (BIS, Ministry of Justice and Scottish Government) and approximately 10% is self-generated.

[77] Where clients repay their debts to creditors after assistance from CCCS, a proportion of those monies repaid to creditors is returned to CCCS.

APPENDIX A

SUMMARY OF RESEARCH REPORTS COMMISSIONED BY THE MONEY ADVICE TRUST AND USED TO INFORM THIS BRIEFING

Demand, capacity and need for debt advice in the UK,
http://www.infohub.moneyadvicetrust.org/content_files/files/demand_and_capacity.pdf
(Dr John Gathergood, University of Nottingham): identifies macro-economic drivers of debt advice and scale of unmet need.

Seeking Direction: men, money and the road to financial health,
http://www.infohub.moneyadvicetrust.org/resource.asp?r_id=647
(Dr Jackie Goode, University of Leicester Centre for Research and Social Policy) gendered attitudes to debt, money management and seeking advice.

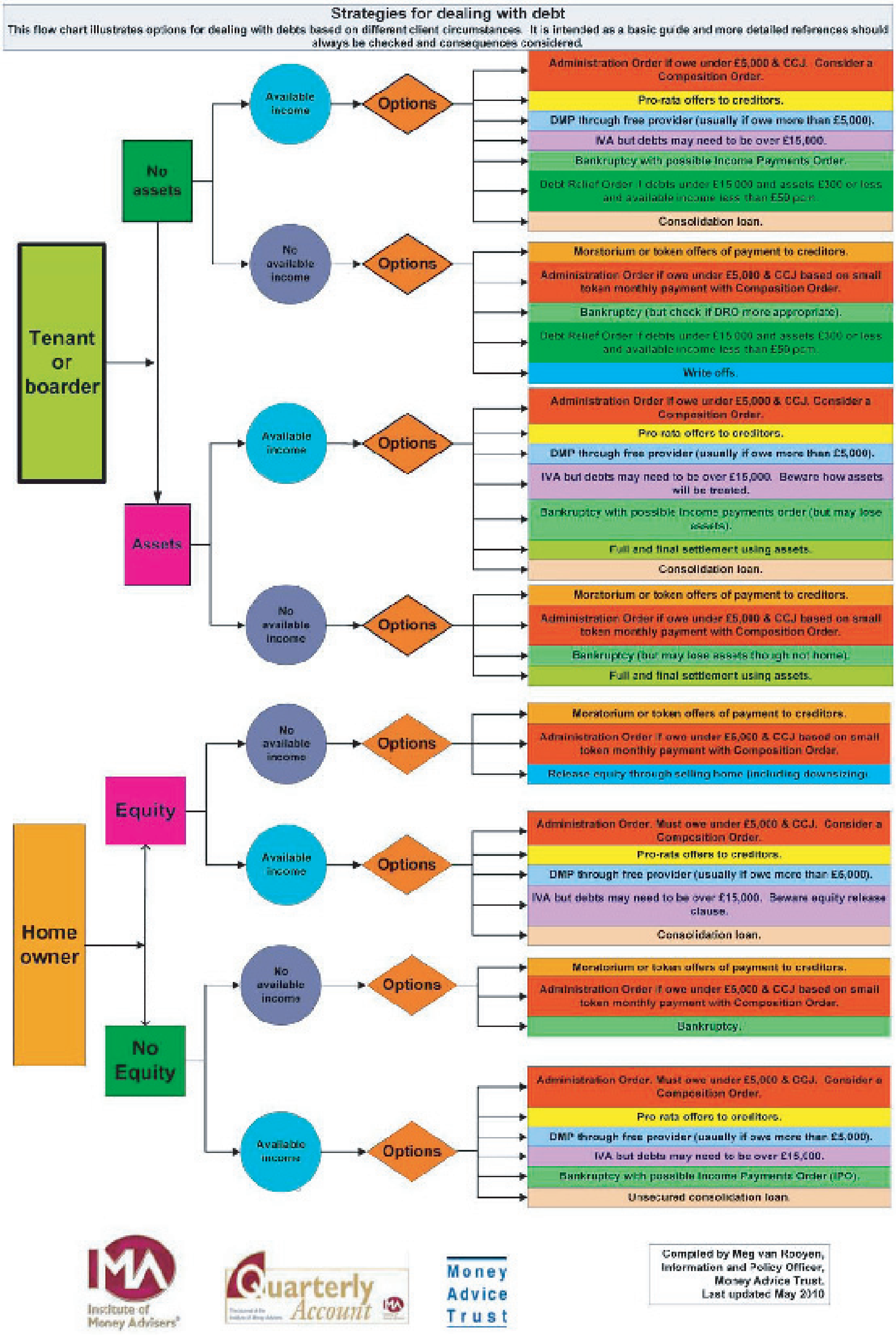
Facing the Squeeze: a qualitative study of household finance and access to credit,
http://www.infohub.moneyadvicetrust.org/content_files/files/facing_the_squeeze_2011_final.pdf:
(Sharon Collard, University of Bristol) identifies the role of "life events" and co-occurrence in creating unmanageable debt.

Understanding financial difficulty: exploring the opportunities for early intervention,
http://www.infohub.moneyadvicetrust.org/content_files/files/facing_the_squeeze_2011_final.pdf
(Sharon Collard, Bristol) outlines successful practice for early identification of and intervention with customers facing unmanageable debt and considerations regarding signposting or referral to third party sources for advice.

Research into channels for debt advice (Policis, publication pending): identifies efficacy and customer satisfaction with different channels (face-to-face, telephone, internet) for debt advice.

APPENDIX B

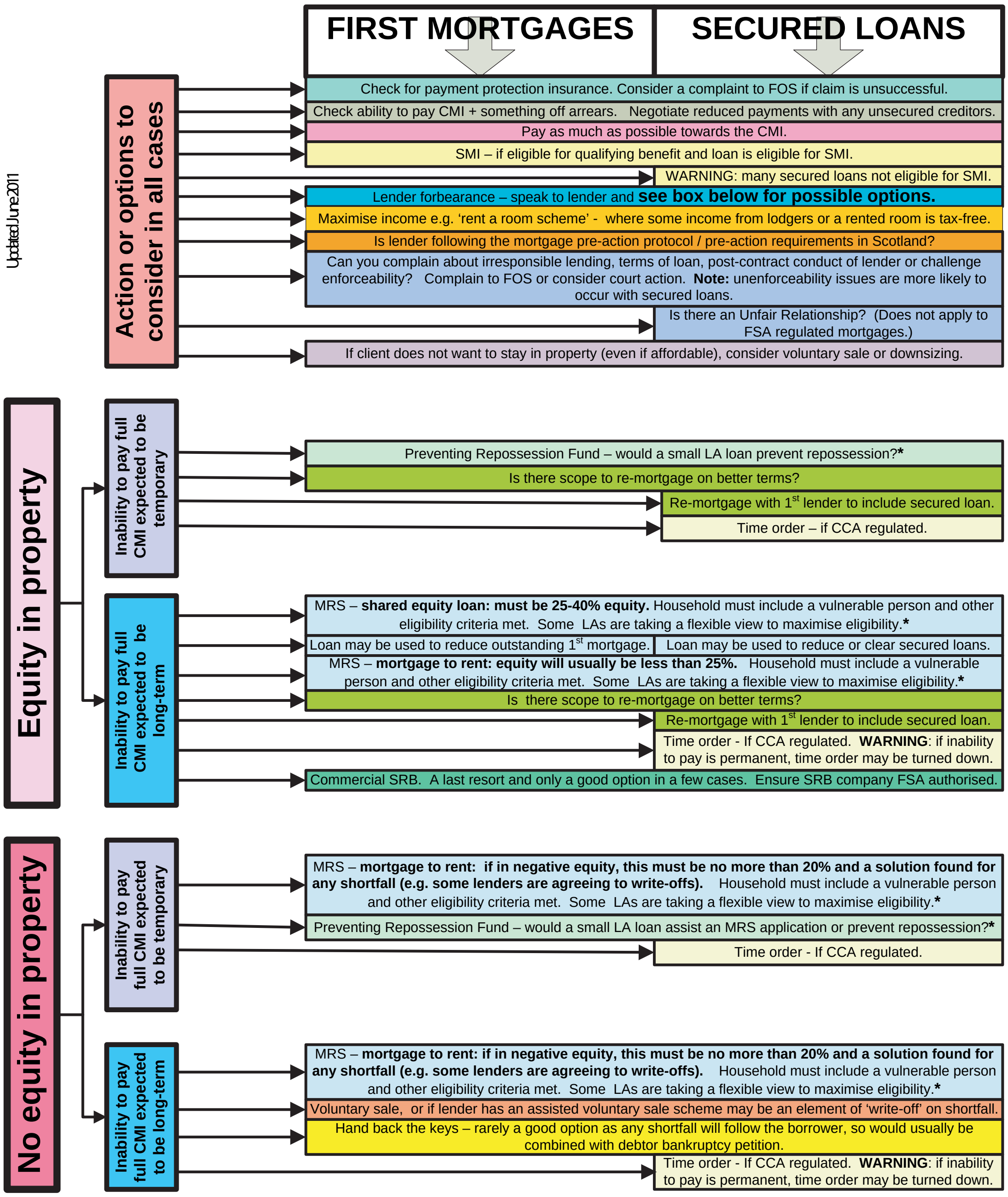
STRATEGIES FOR DEALING WITH DEBT (CHARTS WE PROVIDE TO OUR ADVISERS TO ASSIST CLIENTS IN IDENTIFYING CORRECT REMEDIES)



Strategies when mortgages are unaffordable

This chart illustrates options when there is not enough money to pay the mortgage. Many of these options can be used in a combined approach to tackle mortgage debt. It is a basic guide and more detailed references should always be checked.

Abbreviations: CCA – Consumer Credit Act, CMI – current monthly instalment, FOS – Financial Ombudsman Service, FSA – Financial Services Authority, HMS – Homeowner Mortgage Support, LA – Local Authority, MRS – Mortgage Rescue Scheme, SMI – Support for Mortgage Interest, SRB – sale and rent back,



LENDER FORBEARANCE – some examples

Payment of CMI plus regular amount for arrears	Interest only	Formal loan modification (usually temporary)
Short-term reduction in payments	Reduce arrears charges	Payment holiday
Does lender offer HMS or an equivalent scheme?	Allow time to sell	Lengthen term (possibly capitalising arrears)

*** Apply to England only: Wales and Scotland have similar mortgage rescue schemes; Preventing Repossession Fund is England only.**

Written evidence submitted by MoneyPlan Limited

1. MoneyPlan Ltd is a small, full-service, licensed debt management company working in East London. All customers will have had a free, face-to-face appointment at home with a qualified solicitor, experienced in debt counselling. The company only charges for Plan administration and at the industry average.

2. Key staff include a chartered banker and chartered company secretary, qualified solicitor, qualified broker and an LSE graduate in charge of customer financial administration. The Company was inspected by Trading Standards as part of the OFT Review and no problems were raised. The Company has had no customer complaints.

3. The Company takes its industry responsibilities seriously and all of its submissions were adopted by the DRF in its formal response to the latest OFT consultation.

Introduction/Summary

4. The debt management sector is in transition. Change has been driven by the OFT, encouraged by Government. The companies left standing will be only those centred on compliance, professionalism and customer service.

5. Parliament, however, needs to catch up. It's evident from recent parliamentary debates that most MPs are not up to speed on the changes that are under way. Just as important, they also seem to be completely unaware of the systemic drawbacks affecting charities and companies in the creditor funded sector. These companies and their business model are not the panacea they're portrayed by their supporters.

6. This submission is intended to provide the Committee and Parliament with a small practitioner's view of some of the practical issues surrounding Policy choices and , in particular, to those choices being pursued by the Government in response to the BIS consultation:

Product mix

7. The Company endorses the Government view that the present product mix works well and that there is "no need for a complete overhaul."

8. Some essential changes are needed, however, to the sale and administration of IVAs to prevent continued large-scale mis-selling and the consumer detriment caused by one in three failing. Cause, effect and remedy are covered in the submission.

Money Advice Service

9. The Company supports the existing MAS brief to provide honest, generic advice—informing choice. MAS should not, however, be a feed to specific, creditor-funded companies and charities at the expense of more effective alternatives.

Charities & Creditor funded companies

10. The Submission looks at those companies and charities, like CCCS, that MAS and other Government agencies already refer to , their true cost to the customer, true level of service provision, the effect of creditor funding on service provision, their ambition for the sector and the damage and consumer detriment, evidenced in America, that this would cause if achieved.

Parliamentary comment

11. The submission corrects some of the misleading comment made in parliament.

DMP Protocol

12. The Company supports the Government's efforts to achieve a Debt Management Protocol. However, DMPs are popular and effective because they can be customised to reconcile the competing interests of individual debtors and creditors in many different situations. Any Protocol should facilitate that process and not seek to codify every possible permutation. In short, it should not turn a flexible, all-encompassing solution into something pseudo-statutory—losing features along the way which currently save many customers a great deal of anxiety and a great deal of money.

Submission

Product Mix—IVAs

13. Money Advice Trust and Citizens Advice are both dissatisfied with the way IVAs are marketed, advised and administered. However, their only suggested remedy is increased regulation of Insolvency Practitioners and the firms for which they work. Increased oversight would not increase the number of IPs and consequently

would not address the fundamental flaws in the system which largely stem from inadequate numbers of IPs contributing only notional involvement to the process.

14. It is commonly accepted and confirmed in the Insolvency Service statistics that one in three IVAs fail—taking the customer back to square one after often wasting thousands in front-loaded fees. The proportion of IVAs failing is only likely to increase over the next few years as IVAs are increasingly sold and signed off by Insolvency Practitioners on the basis of £100+ monthly payments. It seems inevitable that such low monthly payments will be wiped out by equally inevitable increases in priority debt payments over the next five years and the customer returned to an even worse position than they had at the outset. IVAs are a high risk product—would anyone buy a car with a one in three chance of blowing up some time in the next five years? Yet IVAs are often marketed as a form of statutory debt management plan rather than, as intended, an alternative to bankruptcy.

15. The answer to ensuring real rather than nominal professional involvement might appear to be to set a minimum ratio between Insolvency Practitioners and the number of IVAs at least notionally being supervised. This would not work—not enough Insolvency Practitioners to go round. In any event, it's only superficially that they might appear to be the right people for the job. The insolvency practitioners' qualification is heavily biased towards commercial/corporate practice and has little practical relevance to the complexities of customising and managing personal debt strategies. The Practice component to the qualification also ensures that it is not an easily accessible qualification. The bottom line is that the requirement for IP involvement has effectively created a closed shop delivering an inadequate service.

16. MoneyPlan believes the answer is to create and phase in a new tailored, qualification—accessible to those with the right experience and professional background. This would ensure real professional input at every stage. Misleading advertising would consequently become pointless. It would also allow and encourage small, professional firms to administer the IVA process in its entirety in-house. This, in turn, would create downward pressure on fees as IVA cases would no longer be "sold-on" to large-scale operators. It also means the customer relationship would be retained rather than transferred to companies employing unqualified staff but with an IP on the letterhead. In this connection, it is perhaps worth noting that even the CCCS only employs one Insolvency Practitioner.

Money Advice Service

17. The Money Advice Service announced in July that it will "perform a central role in the co-ordination of debt advice across the UK from April 2012". It has also told the Advertising Standards Authority in the course of an adjudication that it "did not recommend firms" and "would not recommend a particular provider". Notwithstanding this, the MAS site currently provides a direct link to CCCS and, like many MPs, makes no distinction between the level of service provision in the charity sector and that provided by commercial companies. In short, it is not comparing like with like. Neither MAS nor the 10-minute bills going through Parliament look beyond whether or not a fee is charged in coming to a conclusion on value. It is a wholly inadequate approach which will hopefully be overtaken by the Committee's enquiry. In MoneyPlan's view, any meaningful comparative study should look at the following areas in respect of all service providers—charitable, creditor funded and commercial:

Charities & Creditor Funded Companies

Level of Service

18. Citizens Advice, AgeUK and many other charities provide what at best could be described as "assisted" debt management. The customer is left to organise all creditor payments themselves through their own account i.e. to marry creditor payment dates with, typically, continuously changing collectors and, in addition, deal direct with phone calls and letters from collectors often unaware of any creditor agreement. So payment management skills are still needed and direct creditor and collector contact will persist and have to be responded to if it's not to escalate. CAB itself is aware the service is inadequate and is piloting a tie-up with CCCS. (Payplan withdrew from the tendering process, however, and issued a Press release stating: "having carefully reviewed the tender specification, we concluded that in our view the process was potentially flawed and may not necessarily be in the best interests of the client and felt that the practicalities of the service may also not be effective.")The current arrangement with CCCS generates approx £700,000 DMP commission for Money Advice Trust.

19. Now that there is an open service tie-up between CAB and CCCS it becomes even more important to understand how the CCCS funding mechanism impacts customer service and product advice and how that will now affect CAB customers. CCCS itself is paid on the same basis as a debt collection agency. When it comes to IVA advice, for example, it's clear that the qualifying criteria adopted (average debt: £55000, average monthly payment: £360) are very different from those companies not funded by the creditors. It is not proactive when it comes to controlling debt collection activity and instead just issues a self-help guide to its customers on how to cope and respond. Short settlements are never negotiated directly with creditors. Mis-sold PPI is never reclaimed to reduce balances. Finally, CCCS doesn't advertise. It may be because 60% of CCCS customers are referred by their bank and advertising might undermine the bank's timing of those referrals. Y Fovargue MP said when introducing her 10-minute bill that the lack of advertising reflected the lack of money

available. This seems unlikely. CCCS has £20 million in the bank and generates a surplus of £4–5 million a year.

Direct & Indirect Fees

20. CAB outsources IVA provision and the customer is charged normal commercial rates. PayPlan also charges normal commercial rates for its in-house IVA provision but still continues to say they're free on its website. CCCS has set up a separate subsidiary which also charges normal commercial rates. No charity offers free IVAs.

21. The monthly payment on a debt management Plan is the same in both the commercial and charity sector—with or without fees included. Only the repayment term may differ. However, the overall repayment term is not just affected by fees. In fact, it's more likely to be determined by the effectiveness of the service provider in helping with PPI claims, short settlement negotiation and, especially, getting interest and charges frozen (quickly). A previous director of AdviceUK has confirmed creditor statistics showing that commercial companies are much more effective in this area.

22. Under the so-called "fair share" system, the service provider's interests are aligned with the creditor rather than the customer—the very reason why the FSA is forcing IFAs to start charging fees and stop taking commission. If debt management regulation is moved to the FSA or its successor, continued direct payment by creditors will be short-lived. Charging the customer is transparent, fair and unambiguous.

23. Finally, the Ministry of Justice noted in its Consultation that in the CCCS "fair share" model of funding, "it is not clear that all creditors consider their debt to be settled when the fair share contribution is applied and that some may pursue the debtor for the fee element". I.e. is the Plan fee-free or fee deferred?

Compliance

24. The latest OFT Guidelines are due out before the end of the year. In addition, the Advertising Standards Authority can now also adjudicate on Web content. In that context, those charities and creditor-funded companies that currently pretend IVAs are free and make no reference to the FOS etc will have to change their attitude to regulation.

25. More problematic, in this company's view, is the use of Group licences and how individual compliance can realistically be monitored when large scale umbrella organisations operate under another large scale umbrella organisation. One recent example is Christians Against Poverty (CAP). It's an organisation with 160 branches. They expressly state that they don't help anyone who is self-employed as virtually all the customer's income must be paid into a CAP account . CAP then pays all routine and priority debts with this money as well as the pro-rata payments to unsecured creditors in the DMP. This unusual policy creates a dependency on an organisation with a "mission" and is a hidden barrier to customers cancelling. Contrary to the OFT Guidelines, their complaints procedure makes no mention of the Financial Ombudsman Service.

26. CAP operated under a group licence through AdviceUK until early September 2011when they lost their membership. Chief Executive of AdviceUK, Steve Johnson, said at the time that advisors are not allowed to "offer or impose their values" on their clients. "We don't feel that praying as part of the advice process is compatible with our membership criteria. Advice should be impartial and offered with no strings attached. At the end of the day, praying is not advice. We don't feel it is compatible with what is regarded throughout the advice sector as normal practice."

Parliamentary Comment

The introduction of two 10-minute rule bills and a short debate in July produced a number of statements which appear to coalesce round just one or two issues:

27. It was stated in Parliament that the "fair share" model employed by CCCS aligned the interests of the service provider with the debtor and should be encouraged. Clearly, when the service provider's income comes exclusively from the creditor on exactly the same basis as a debt collection agency, the service provider's interests are aligned with the creditor and not the debtor. The principle involved is underlined by the FSA now forcing all IFAs to start charging fees to their customers instead of taking commission on the products sold. Fees are transparent and unambiguous. It was also stated that the fair share "model enables charities such as CCCS to help nine out of 10 people lacking the means to repay their debt". Regrettably, CCCS' own statistics show that of the 418,000 people that contacted them for help in 2010, just 28,419 went on to start a debt management plan (ie 6.7%).

28. A ban on front-loaded fees was suggested in Parliament. This idea was also the subject of a super-complaint by CAB to the OFT. The issue was researched and carefully considered by the OFT. It was then rejected.

29. A ban on the sale of consumer data to debt management companies was suggested, in Parliament, to prevent cold calling. MoneyPlan doesn't engage in cold calling. It should perhaps be pointed out, however, that the sale and packaging of much of the data bought by others is produced by the Registry Trust (a NFP set

up by Malcolm Hurlston of the CCCS) on the basis of information originating from the Ministry of Justice re CCJs etc. and to which it returns much of the proceeds.

30. Banks, it was said in Parliament, should be stopped from referring customers to debt management companies. This does happen and is probably wrong—not least because the customer may well feel intimidated or that they have no choice if they are to stop the bank escalating collection activity. In this connection, however, it should be noted that 60% of all CCCS customers are referred by their bank.

31. It was stated in Parliament when introducing one of the 10-minute bills that free advice providers could not expect recommendations as people don't talk to each other about debt. That is not MoneyPlan's experience. Approx a third of all new business to MoneyPlan is a result of personal recommendation from existing customers and is likely to be the same for other similar companies.

32. A cap on fees to restrict advertising spend and an ambition that Britain should follow the "success" of the American model was put forward by CCCS in their response to the OFT consultation and to the BIS call for evidence. In MoneyPlan's opinion, there would be two key consequences of following the CCCS policy:

33. CCCS has the money but chooses not to advertise. Consequently, if private companies are stopped from advertising, it would simply mean far fewer people getting advice before the bank's collection activities had run their course or the customer had succumbed to a consolidation loan—ruling out, permanently, many of their options.

34. Fee capping in America was not a success. When commercial companies deserted the industry, the banks took the opportunity to reduce their support and the CCCS in America is now dependent on State grants and fees charged customers. In the last figures seen by MoneyPlan for the CCCS accounts in Orange County, California, creditor contributions were $399,642, fees charged customers were $579,753 and grants were $448,829.

Debt Management Protocol or Statutory Debt Management Plan?

35. Although CAB and the CCCS have now linked up, they have differing views on statutory debt management plans. The response from the CCCS when no consensus could be reached was basically a sigh of relief. In June 2010, the Chairman wrote in the Consolidated Financial Statement: "to regulate plans in general would certainly have put at severe risk the service we offer, which is based on goodwill and informal agreements which bring the best out of lenders and motivate people in debt. It was fortunate when in 2010 the Government decided not to take it forward after pressure from both Bankers and ourselves."

36. MoneyPlan agrees with the CCCS on this. It is the co-operative and flexible nature of DMPs that has made them so successful for so many people in so many different circumstances. The experience of IVAs should be a lesson in what happens when all flexibility is lost and individuals are forced into the straight-jacket of a statutory system.

37. Although this Company has never had any difficulty in setting up sensible Plans, there can be no objection to the Government's wish to see all parties agree on a Protocol—providing it does not negotiate away many of the best features of the present system or become pseudo-statutory in its employment.

11 November 2011

Supplementary written evidence submitted by MoneyPlus Group

Response to questions from the Business, Innovation and Skills Committee

1. [to DEMSA and DRF] *What have you done since the OFT investigation to improve standards in your industry? What evidence do you have of improvements?*

MoneyPlus Group Response—We understand that DEMSA has responded to this question. We have had sight of the response and fully support it. As a company that is a member of DEMSA we are particularly encouraged to see that DEMSA continues to raise the bar in relation to the standards that its members must achieve. We believe that the new measures taken by DEMSA will provide reassurance to consumers, creditors and legislators that the service offered by DEMSA members is the best in the commercial sector.

2. [to DEMSA and DRF] *How many firms have broken your trade association codes in the last 12 months? What action have you taken against them?*

MoneyPlus Group Response—We understand that Demsa has responded to this question.

3. *Last week we heard that there needed to be much more transparency in the commercial debt advice market—would you agree? Do you currently publish figures on, for example, the number of people you recommend an individual voluntary arrangement or debt relief order? If not why not?*

MoneyPlus Group Response—We support the view that a consumer should be aware of as much information as possible in order to make a qualified decision as to which avenue of advice to take. Each case of consumers finance is different. Each has to be judged on its own merits. As a member firm of DEMSA we are subjected to a degree of mystery shopping each year. This exercise demonstrates that we act in the best interest of each consumer. We will only advise a consumer on a particular service if their circumstances merit it. Presently MoneyPlus Group assists circa 24,000 consumers with either debt management plans or IVAs. In addition where appropriate we signpost consumers for Trust Deed advice, advice on Debt Relief Orders or inclusion in a Debt Advice Scheme. It is worthy to note that even though the total fees charged by us a company in respect of IVA advice across a 5 year period is 50% greater than that charged to a consumer in a DMP, only 1 in 10 of our consumers finds relief in an IVA.

4. *What percentage of your debt management plan customers are still making their debt management plan payments after 24 months?*

MoneyPlus Group Response—69% of the consumers that we represent have been in a debt management plan for more than 2 years. Of the balance, namely 31% a proportion will have concluded their plan given the fact that during the first 2 years they will have regained control of their finances. As such, we would submit that the success of a plan should be judged against the back drop of a consumer being in a position to take back control of their finances, rather than the plan running full term.

5. *Do you make people who contact your organisations aware of the availability of free debt advice? Should you?*

MoneyPlus Group Response—In 2010 the National Audit Office found that amongst over indebted consumers there was a 97% awareness of the Citizens Advice Bureau. On average each consumer that we have in some form of plan has 7 creditors. Each consumer by the time that they make contact with us will have received correspondence from his/her bank. This correspondence will sign post the consumer down the route of free advice. Indeed we act for consumers who have contacted the free sector but choose to instruct us to deal with their affairs. It is apparent to us from speaking with a large number of consumers that many are already aware of the services offered by the free sector. Consumers often choose MoneyPlus Group over the free sector as many are attracted by the discrete and immediate service that we offer, with advice being given at arms length over the telephone often at times out of normal office hours, to suit the individuals need.

6. *Do you educate people who come to you about financial planning and budgeting so they are better able to manage their finances in future? Do you think there is capacity for you to do more of this?*

MoneyPlus Group Response—We impress on consumers the need for them to budget. We work with them in order to identify a realistic plan that they can stick to. As a commercial company it is not in our interest to see a plan fail. We impress on consumers the absolute need to make payments not only to their debts, via a debt management plan, but also to priority debts such as a mortgage. In each case if we believe that a consumer is not receiving the correct benefits we will try and work with them to identify what they should be applying for. In addition we will challenge them if they are spending money in areas where this spend is unnecessary. We will continue to assist consumers in attempting to identify areas in which they can save additional expenditure.

7 December 2011

Written evidence submitted by the Office of Fair Trading (OFT)

1. This statement provides the Committee with a brief introduction to the OFT's role and remit under the Consumer Credit Act 1974 (the Act), and a recent history of our work in the debt management and high cost credit markets in particular.

The OFT's Role and Remit

2. The OFT's mission is to make markets work well for consumers. We aim for competitive, efficient and innovative markets where standards of consumer care are high, consumers are empowered and confident about making choices, and where businesses comply with consumer and competition laws but are not overburdened by regulation.

3. The OFT is responsible, under the Act, for licensing firms engaging in consumer credit activities. Our role involves the assessment of businesses' fitness to engage in licensable credit activities before they are granted a licence and monitoring their continued fitness thereafter. Our role is to assess whether the conduct of traders makes them unfit to trade; we do not have powers to regulate particular products.

4. To be fit, a business must satisfy the OFT that it meets the necessary standards of integrity and competence to enable it to deal properly with consumers. In determining whether a business is fit, the OFT can have regard to any matter it considers relevant, but the Act specifies certain matters to which it should have particular regard. These include whether a business, the individuals who run or control it, or their associates have any convictions for fraud, dishonesty or violence or have engaged in unfair business practices. Since 2008, following reforms introduced by the Consumer Credit Act 2006 (CCA06), these matters have also included a firm's "competence" to engage in regulated credit activities. In assessing competence we seek to establish whether the skills, knowledge and experience of applicants and those participating in a business, and the practices and procedures an applicant proposes to operate, are adequate to carry out the activities covered by a licence to a reasonable standard.

5. The licensing requirement is broad in scope and covers not only lenders and brokers of credit but all businesses "concerned with the provision of credit". So, for example, those who collect consumer credit debts on behalf of lenders, or offer debt management services to consumers need to be licensed. The wide scope also means that many licensed businesses are not financial services businesses themselves but provide their customers with access to credit provided by a lender. The licensed population thus includes many providers of goods and services such as high street retailers, car dealerships or home improvement firms. These account for approximately half of the current licensed population of around 84,000 firms. One consequence of this is that around one third of licensed businesses are sole traders and just over two thirds employer fewer than ten people.

6. The issues currently facing the OFT in discharging its responsibilities under the CCA are dominated by four broad themes:

- The unfair treatment of consumers in financial difficulties who are no longer able to service their debts.
- The unfair treatment of consumers who are otherwise vulnerable, for example through age, mental capacity limitation, or poor financial literacy.
- The irresponsible treatment of consumers seeking credit, often where they have limited access to mainstream provision as a result of impaired credit records or low incomes.
- Preventing entry into credit markets of individuals with a history of violent or fraudulent behaviour or firms which simply lack the competence to meet expected standards.

7. Since the introduction of new powers in April 2008, the OFT has operated a risk-based strategy based on:

- A strong gateway to exclude violent, fraudulent or otherwise unfit traders from the market.
- Developing clear, practical guidance and driving up standards of behaviour.
- Credible deterrence through targeted high impact intelligence-led enforcement, particularly focused on issues of wider market significance.

8. Our gateway risk model treats debt collection, debt management, secured sub-prime lending and lending in the home as high risk activities. We have subjected these businesses to a greater degree of scrutiny at the application stage and have conducted a rolling programme of thematic compliance reviews and enforcement work in these sectors. More detail on our approach to debt management and high cost lending is set out in sections 2 and 3 of this note.

9. Our enforcement work is complemented by active engagement with industry to drive up standards. We work closely with trade associations and other forums to ensure firms are aware of their responsibilities under the Act and the OFT's expectations. We have produced a suite of sectoral and cross-cutting guidance setting out the standards we expect of businesses engaging in particular regulated credit activities and making clear the behaviours which the OFT considers will call a firm's fitness into question and may trigger enforcement action. A summary of the OFT's key guidance documents is set out at Annexe A.

10. This guidance does not have the status of rules or legislation. It does not place positive obligations on firms, but rather sets out the behaviours or omissions which may be likely to lead to OFT enforcement action. Statutory obligations on firms are set out in the Act. A significant portion of these are governed by the maximum harmonisation European Consumer Credit Directive.[78] Policy responsibility for the Act rests with the Department for Business, Innovation and Skills (BIS).

11. Where firms fail to meet the standards set out in legislation or guidance, or engage in activities which the OFT considers to be otherwise unfair or improper (whether lawful or not) the OFT can take enforcement action. Breaches of certain statutory requirements (such as engaging in regulated activity without a licence or breaches of the advertising regulations) are offences enforceable through the courts by OFT and by Local Authority Trading Standards Services including specialist Illegal Money Lending Teams set up by BIS in 2004.[79] In practice, however, most enforcement action is taken forward under the OFT's licensing powers. If dissatisfied with a firm's behaviour the OFT can issue a warning letter or impose requirements on its licence. Requirements are flexible and can be tailored to the specific behaviour in question, for example, we can require firms to cease particular behaviours or to put in place processes to safeguard against future misconduct. If requirements are not adhered to we can levy fines of up to £50,000 per instance of non-adherence. If the OFT considers that a firm's behaviour is so serious that it is not fit to trade we can take steps to revoke its licence. We are not obliged first to impose requirements: we can, and frequently do, move straight to revocation proceedings.

12. We have supporting investigatory powers, including information gathering powers and powers of entry and inspection. The OFT also has enforcement powers under other consumer protection legislation including the Enterprise Act 2002 and the Consumer Protection from Unfair Trading Regulations 2008 which it may use against licensees where appropriate.

13. Once formal actions are completed this information is publicly available via the Public Register on the OFT website and is usually accompanied by a Press Release. Between April 2009 and March 2011 the OFT

78 Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers

79 Breaches of the advertising regulations (and of wider advertising standards) are also addressed by the Advertising Standards Association, in consultation with the OFT

revoked or refused the licences of 104 firms and placed requirements on a further 53. A more detailed summary of recent enforcement activity can be found at Annexe B.

14. The regime is fully funded through industry fees. Our budgeted income for 2011–12 is approximately £10 million. This is raised by a fee of £435 for sole trader or £1075 for other firms when applying for or renewing a licence. As the fee is collected on a five year cycle this is equivalent to an annual fee of £87 or £215 respectively. In addition, all firms pay a flat levy of £150 to fund the Financial Ombudsman Service, which we collect on their behalf alongside the fee.[80]

15. Further financial and operation information about the regime is provided at Annexe C.

2. The OFT's Approach to Debt Management

1. Well before the current economic downturn the OFT had identified debt management as a high-risk area. Debt management services are a classic "distress" purchase; consumers seeking debt management help tend to be over-indebted, vulnerable and desperate for help. Research by the Money Advice Trust has shown that consumers do not shop around for debt management services.[81] Consumers are potentially committing themselves to a debt solution which can affect their lives for years. The risks if things go wrong can be significant, potentially leaving consumers in a worse financial position, which in some cases can include the loss of the consumers' home.

2. As part of the OFT's wider compliance strategy of rolling targeted reviews of high risk sectors, and against a background of rising complaints and rapid growth in new entrants to the fee charging debt-management sector operating mainly over the internet, the OFT carried out a compliance review of the sector in 2009–10.

3. We set out our findings in September 2010.[82] The review found that:

- There was widespread non-adherence to the standards set out in the OFT's Debt Management Guidance by debt advice and debt management licensees, with most debt management firms audited failing to meet expected standards to some extent in at least three areas.
- Misleading advertising was the most significant area of non-aherence, in particular misrepresenting debt management services as being free when they are not.
- Frontline advisers working for debt management companies generally lacked sufficient competence and were providing consumers with poor advice based on inadequate information.
- Industry awareness of the Financial Ombudsman Service scheme for resolving consumer complaints was low and there was widespread non-compliance with the Financial Ombudsman Service's complaint handling rules.
- The two main trade associations, the Debt Managers Standards Association (DEMSA) and the Debt Resolution Forum (DRF), needed to do more to lead the way by introducing more robust compliance monitoring and auditing systems for their members.
- Stakeholders found the Guidance to be clear and understandable but it needed to cover new emerging practices, and to give greater clarity on expected competence levels, advertising standards, transparency of fees, and the "best advice" principle.
- There was a strong expectation and desire that the OFT would continue with its programme of pro-active compliance monitoring and take strong action to remove unfit traders from the market.

4. The OFT issued warnings to 129 debt management firms following the publication of its compliance review. Of these, 53 businesses have since exited the market. A further 17 firms have exited the debt management market as a result action outside the review since September 2010.

5. In addition to individual cases, we have also taken action against multiple firms at once to tackle areas of particular bad practice in the market. This has included several actions over the past three years against firms that sent misleading IVA mailings to consumers, used "look-alike" websites to mislead consumers into believing that they were charity-based sources of free debt advice, and engaged in cold calling in a way that breaks the law.

6. In light of the findings of the compliance review, the OFT has revised and updated the Debt Management Guidance, setting out more clearly specific practices which we regard as unfair or oppressive. The revised guidance was issued for consultation in June 2011 and we expect to publish final guidance in January 2012. We have an ongoing pipeline of enforcement investigations. Details of those cases where we have issued a notice that we are minded to take licensing action can be found at http://www.oft.gov.uk/OFTwork/credit/enforcement-action/

[80] Excepting those firms that are authorised by the Financial Services Authority and have therefore already paid the levy via this route.
[81] *An independent review of the fee-charging debt management industry,* Money Advice Trust, June 2009
[82] See http://www.oft.gov.uk/about-the-oft/legal-powers/legal/cca/debt-management

3. The OFT's Approach to High-Cost Credit and Payday Lending

1. In June 2010, in response to concerns that markets for high-cost credit may not be working well for consumers, the OFT published a study of the market for the provision of high-cost credit[83] (pawnbroking, payday and other short-term small sum loans, home credit and rent-to-buy credit).

2. The study made a number of recommendations for improvements to the market which the Government has responded to in its Consumer Credit and Personal Insolvency Review. A short note setting out the problems and features of the market identified by the study and the recommendations made is attached as Annexe D.

3. However, the OFT made clear that the recommendations made would have limited effect on the market. The kinds of action necessary to tackle the more deep-seated concerns raised, such as securing a step-change in the financial capability of low-income consumers or intervening in the market to expand the availability of credit to those consumers, would have highly significant economic, financial and social consequences and are outside of the OFT's remit.

4. Whilst price control remedies such as interest rate caps were considered, the study concluded that these would not be an effective solution to the particular concerns identified. Broadly, this was due to concerns that:

— This would be likely to lead to credit suppliers either restricting availability of their products or exiting the market altogether, which could lead to poorer outcomes for some consumers and for the economy through the impact on consumption.

— A system of price controls would be complex, expensive and difficult to administer.

5. Alongside an examination of competition and consumer choice in high-cost credit markets, the OFT has focused on improving standards of consumer protection in the sector. In March 2010 we published the Irresponsible Lending Guidance, building on the requirements on lenders set out in the new European Consumer Credit Directive. This Guidance makes clear the OFT's expectation that firms should take appropriate steps to assess the affordability of any loan, considering the borrower's ability to take on an additional credit commitment and to meet any repayments in a sustainable manner without incurring further financial difficulties or other adverse consequences.

6. The OFT is closely monitoring the payday lending market, which is a key area of regulatory focus. At the time of the High Cost Credit Review consumer complaints about the market were relatively low. Since then we have seen a rapid expansion of the sector, particularly in online provision. It is estimated that the number of payday loan borrowers rose from 0.3 million in 2006 to 1.2 million in 2009.[84] Although the precise current market size is disputed, it is clear that it is continuing to expand at pace, both online and on the high street. Linked to this, there has also been an expansion of brokerage and lead generation activities—firms which pass on consumer details to payday lenders for a commission. The sector is also experimenting with new channels to market, for example, lending via text message and smartphone apps.

7. Alongside this growth, we have seen an increase in reported consumer harm, particularly over the last 12 months. The overall level of complaints to the Financial Ombudsman Service about payday lending is low, relative to some other products, but increasing. We understand that 81 complaints cases were completed or closed between January and November 2011. This is an increase of 72% over the same period last year, and the rate of increase in complaints upheld is 171%. In addition to this, since 1st January 2011, there remain 180 open complaints about the sector. By way of comparison, completed or closed cases about the home credit sector are decreasing (by 26% this year) with a 50% decrease in the number of complaints upheld. Complaints to Consumer Direct have shown a greater increase, from 700 complaints in 2010 to 1535 complaints in the first eleven months of 2011. We are seeing similar patterns in complaints passed to us by debt advice agencies.

8. The main areas of concern we see are:

— The misuse of continuous payment authority—where lenders use the facility to take payments direct from a consumer's bank account to recover repayments where a consumer has defaulted, which may result in the borrower incurring unauthorised overdraft charges or struggling to meet priority debts (such as mortgage repayments) and essential living expenses.

— Rollover of loans—which can significantly lengthen the repayment period and rapidly escalate the outstanding debt.

— Irresponsible advertising and sales practices—for example, lenders emphasising access to quick cash, such as "decisions in seconds" or transfer of funds within an hour. An emphasis on speed may mean affordability assessments are not conducted properly and consumers are not given a clear explanation of the product and associated risks.

— Targeting potentially vulnerable consumers—such as the disabled, the unemployed or those with bad credit histories, including concerns that in many cases such lenders may not be conducting appropriate credit checks and affordability assessments.

— Transparency concerns—this includes a lack of clarity about who consumers are dealing with, with websites not making clear whether they are a lead generator, broker or lender, and not providing basic contact details.

[83] The study is available in full from http://www.oft.gov.uk/OFTwork/credit/review-high-cost-consumer-credit/

[84] *Keeping the plates spinning—Perceptions of payday loans in Great Britain,* Consumer Focus, August 2010

— Treatment of customers in arrears and default—evidence of unfair debt collection practices and a failure to exercise forbearance and consideration towards borrowers in financial difficulty.

9. In light of our significant concerns about the market, we are tightening our approach to the scrutiny of new applications and renewals for the sector, alongside a programme of investigatory and enforcement action.

10. The OFT has conducted an initial advertising sweep of a sample of online payday loan websites. This has identified a number of examples of the issues set out above. These include:

— A lack of transparency regarding the product on offer.

— No or inadequate affordability assessments.

— Absence of adequate pre-contract explanations.

— A lack of clarity regarding arrears handling and charges.

11. A more comprehensive advertising sweep is currently being undertaken, encompassing a more diverse spread of websites of approximately 50 lead generators and firms which are not members of a trade association.

12. To date, the OFT has taken enforcement action against two payday lenders. In late 2010 we imposed requirements on CIM Technologies Ltd, trading as "Toothfairy Finance Ltd" and on Safeloans, trading as "Paydayok", for a range of breaches including misuse of continuous payment authority. We also took action in April this year to shut down 10 unlicensed payday lead generation websites targeting people with disabilities, military personnel and their families, and consumers with poor credit histories as part of a wider action against unlicensed lead generators. Other action is ongoing but we are unable to comment on active investigations.

13. The OFT will launch a review of compliance with the Irresponsible Lending Guidance in the payday lending market in the New Year. The review, the detail of which we are still working on, will assess and test wider compliance levels across the sector, identify practices harming consumers and assess reasons for non-compliance. We intend to use the findings to take further enforcement action, where appropriate, and as the basis for ongoing liaison with the industry to drive up standards.

14. In parallel, we will take appropriate enforcement action on the basis of non-compliant online advertising identified in the sweeps described above.

15. At this stage, we expect to launch the compliance review early in the new year. We will publish details of any resulting enforcement action as and when cases are completed.

Annexe A

KEY OFT GUIDANCE DOCUMENTS

Irresponsible Lending Guidance. Revised and updated February 2011. Sets out guidance for creditors on the practices OFT considers may constitute irresponsible lending. Applies to all creditors and covers each stage of the lending process from advertising and marketing through to the handling of arrears and default.

Debt Collection Guidance. Revised and updated October 2011. Covers all firms involved in the recovery of consumer credit debts, including creditors, debt collection agencies, debt purchasers and tracing agents. Significant updates were made this year to take account of market changes, including the growth of debt purchase and debtor tracing and the emergence of new practices such as the use of continuous payment authorities.

Debt Management Guidance. Revised and updated guidance to be issued January 2012. This covers all firms engaged in debt management activities, both fee charging and free-to-client. Significantly updated following the recent compliance review to take account of market developments and to set out more explicitly specific examples of practices the OFT considers unfair or oppressive.

Mental Capacity Guidance. Issued September 2011. Seeks to provide clarity for creditors on the OFT's expectations of them in relation to the treatment of borrowers with known or suspected mental capacity issues, particularly in the context of responsible lending and borrowing decisions. Aims to afford better protection to particularly vulnerable consumers from unsustainable borrowing, whilst also ensuring that they are not inappropriately denied credit.

Guidance for Credit Brokers and Intermediaries. Issued November 2011. Sets out the OFT's expectations of brokers and intermediaries, in particular in respect of transparency with regard to their status and the nature and amount of any consideration received. Clarifies what the OFT considers to be the responsibilities of relevant businesses (primarily creditors) for the activities of third parties with whom they do business.

Second-Charge Lending Guidance. Issued July 2009. Applies to all firms offering second mortgages and secured personal loans.

Annexe B

SUMMARY OF OFT ACTIVITY 2010–11

Licensing Applications	*Enforcement*	*Licensing Decisions and Appeals*
The OFT received: - 7,552 new applications - 5,718 renewal applications - 3,239 variation applications The OFT exceeded its key Performance Indicator (KPI) target of over 90% of low risk cases completed within 25 working days and the KPI target of over 75% of high risk cases completed within 90 working days	The OFT received 4,830 complaints about licensed traders. The OFT served 124 notices on applicants and licensees about their fitness to be granted, or to retain, a licence. This included: - 75 "Minded to revoke" and existing licence - 25 "Minded to refuse" and application for a licence - 7 "Minded to refuse renewal" of an existing licence - 1 "Minded to revoke or refuse the variation of terms" - 1 "Minded to grant in different terms" - 1 "Minded to refuse application to vary" - 1 "Minded to refuse renewal of an existing licence and compulsory vary" The OFT also issued 13 "Minded to impose requirements" notices	OFT adjudicators considered 106 licensing cases: - 13 favourable determinations - 67 adverse determinations - 2 applications withdrawn - 15 licenses surrendered - 1 licence expired - 16 OFT "minded to" notices withdrawn - 26 cases still under consideration at the end of the period The First Tier Tribunal considered 17 appeals against decisions taken by OFT adjudicators: - 0 appeals upheld - 2 appeals dismissed - 2 appeals struck out - 4 appeals withdrawn - 9 appeals still under consideration at the end of the period

Key Actions since November 2010

- 2 November 2010: OFT crackdown on illegal cold-calling practices in the debt management sector—including licence removal from major lead generation firm Compensation Professionals Network Ltd (Basingstoke)
- 9 November: Requirements imposed on unsatisfactory business practices of payday lender CIM Technologies Ltd, known as Tooth Fairy Finance (London)
- 22 November: OFT acts on concerns about charging orders—requirements action against Alliance and Leicester Personal Finance Limited, American Express Services Europe Limited, HFC Bank Limited (part of the HSBC Group) and Welcome Financial Services Limited (part of Cattles plc)
- 23 November: OFT takes action against unfair debt recovery practices—requirements action against debt recovery company Aktiv Kapital (Bromley, Kent)
- 6 December: Consultation on Mental Capacity Guidance launched
- 14 December: Requirements imposed on credit card lender MBNA Europe Bank Limited to secure improvements to the way its in-house debt collection arm deals with customers in financial difficulties
- 16 December: London North Securities Limited convicted of unlicensed trading and ordered to pay £400k compensation to customers
- 17 December: Further action taken to address unfair direct debit clauses in payday loan contracts
- 20 December: OFT issues more than 50 warning letters to the home collected credit (doorstep lending) industry

2011

- 28 January 2011: OFT announces that 35 debt management firms have surrendered their consumer credit licences and that it is taking further licensing action against at least a further 15 as a result of an OFT compliance review
- 11 February: OFT revokes the credit licences of two associated businesses NIZ Financial (UK) Ltd (Stockport) and First Money Direct Ltd after uncovering unfair business practices. OFT warns the credit broking market to improve the way they deal with customers' upfront fees or risk losing their licences
- 22 February: Requirements imposed on Money Advice Direct Limited (London), a lead generating firm introducing people to debt advice providers via its website
- 15 March: OFT consultation on revisions to the guidance for group licensing closes. Amendments and updates to the guidance to follow
- 30 March: OFT launches consultation on revised debt collection guidance

- 8 April: Closure of 19 unlicensed lead generation websites
- 15 April: OFT revokes companies' licences for misleading IVA mailings
- 1 June: OFT announces package of measures to address concerns over credit practices and publishes its Which? super-complaint response
- 14 June: Revised debt management guidance published
- 5 July: OFT revokes the licence of debt management company, Parkgate UK Limited (Haywards Heath), after it sent a threatening letter to a debt collection agency
- 22 August: After seeing a 50 per cent year-on-year rise in complaints about loan scams the OFT issues a consumer alert warning people to steer clear of scam loan companies who take upfront fees but fail to provide credit or offer clearly unsuitable credit alternatives
- 13 September: The OFT warns companies collecting consumer credit debts to make sure they communicate clearly and fairly and do not mislead consumers after the First-tier Tribunal upheld the OFT's decision to revoke the consumer credit licence of Carltons Business Limited (Dartford, Kent)
- 21 September: The First-tier Tribunal upholds the OFT's decision to revoke the licence of JST Financial Solutions Limited (JST) because the company allowed a convicted fraudster to become involved in its business
- 28 September: Revised mental capacity guidance is published
- 10 October: The OFT takes action against a further three debt management businesses as part of its ongoing enforcement work in the sector (Prime Legal and Financial Services (PLFS), Mile End, London; Midlothian-based Deric Hamilton Oliver; and London-based Money Advice Direct Limited (MADL))
- 19 October: Updated Debt Collection Guidance published
- 18 November: OFT welcomes Tribunal's decision to strike out Log Book Loans' appeal
- 24 November: OFT publishes guidance for credit brokers and intermediaries

Annexe C

FINANCIAL AND OPERATIONAL INFORMATION

Budget and resources

The regime is fully funded through the licence fee. Our budgeted income for 2011–12 is approximately £10 million. This is raised by a fee of £435 for sole trader or £1075 for other firms when applying for or renewing a licence. As the fee is collected on a five year cycle this is equivalent to an annual fee of £87 or £215 respectively. In addition, all firms pay a flat levy of £150 to fund the Financial Ombudsman Service, which we collect on their behalf alongside the fee.[85]

As at November 2011, 126 staff are employed full time in the delivery of the current consumer credit regime. Of these:

- 61 are engaged in investigation and enforcement, including sectoral compliance reviews,
- 28 are engaged in the licensing function,
- 14 are involved in developing industry guidance and policy and collating market intelligence.
- 13 are dedicated lawyers and adjudicators
- 10 provide business support functions

Back office, communications, infrastructure and governance functions are provided by OFT centrally, met by a financial contribution reflecting Credit Group's share of total OFT overheads.

Licensed population, application levels and fees

As at November 2011 there were approximately 84,000 consumer credit licenceholders, of whom 50,500 have obtained or renewed their licences under the new standards introduced in April 2008 by the Consumer Credit Act 2006 (CCA06). An estimated 53% of consumer credit licenceholders describe their primary activity as some form of financial services provision (including debt related services). The remainder engage in wider retail activities, mostly introducing consumers to credit to finance the purchase of goods and services.

32% of licensed firms are sole traders, 8% partnerships, around 58% corporates, and 2% others such as charities and clubs. An estimated 70% of licenceholders are micro-enterprises, employing fewer than 10 people.

The number of credit licence applications has been steadily declining over a number of years. The table below illustrates the decline in applications since April 2008 along with the income generated under the regime.

[85] Excepting those firms that are authorised by the Financial Services Authority and have therefore already paid the levy via this route.

Year	New Applications	Renewals	Variations	Total	Income (£k)
2008–09	11,068	7,050	4,233	22,351	£9,233
2009–10	8,475	6,828	4,017	19,320	£10,322
2010–11	7,552	5,718	3,239	16,509	£9,236
2011–12	6,413	4,846	2,747	14,006	£10,004

Applications for a new licence, and for renewal or variation of an existing licence attract a charge. There are different new and renewal application fees for sole traders and other firms. Applications for group licences and directions under s60(3) [waiving of certain requirements regarding form and content of documents embodying regulated agreements] and S101(8) [dis-application of certain conditions for hire agreements] of the Act also attract a fee.

The vast majority of income generated under the regime is through new and renewal applications. The fees charged for new and renewal 5 year licence applications are as follows:

- £435 (equivalent to £87 pa) for a sole trader
- £1075 (equivalent to £215 pa) for other applicants

The table below shows changes to the level of new and renewal application fees since the changes introduced by CCA06 were implemented in April 2008.

	Sole Traders	Others
2008–09	230	575
2009–10	330	820
2011–12	435	1075

Annexe D

HIGH-COST CREDIT STUDY: SUMMARY OF FINDINGS

The study found some positive features of high-cost credit markets:

- They fill a gap in the market not served fully (or at all) by mainstream financial suppliers, providing significant groups of consumers with access to lawful credit that they might not otherwise have.
- There is evidence with some products that lenders show a degree of forbearance towards those with repayment difficulties and do not penalise borrowers when payments are late or missed.
- The level of complaints from consumers was low at the time of the review.

However, the study also found problems with competition in the market:

- On the demand side, there was relatively low ability and effectiveness of consumers in driving competition between suppliers, given their low levels of financial capability.
- On the supply side, sources of additional supply such as mainstream financial suppliers seemed to be limited.
- In such circumstances, competition on price is limited and there appeared to be some suppliers charging higher prices than would be expected.

The study made a number of recommendations, under the following headings:

- *Helping consumers make informed decisions on high-cost credit*—e.g. extending financial literacy programmes to cover high-cost credit, making comparisons between products easier through the use of comparison websites, and considering whether providers could be required to include “wealth warning” statements in advertisements for high-cost credit
- *Increasing the ability for consumers to build up a documented credit history when using high-cost credit*, with Government and credit reference agencies to explore ways in which providers could provide suitable information to credit reference agencies about the payment performance of their customers
- *Enhancing understanding of developments in the high-cost credit sector*, through OFT collecting information on the high-cost credit sector, such as the volume, value and pricing of credit, levels of repeat business and default levels among customers
- *Promoting best practice among suppliers of high-cost credit*, through the relevant trade associations for home credit suppliers, payday lenders and pawnbrokers establishing a code or codes of practice covering best practice policy.

Written evidence submitted by Payplan

Executive Summary

1. The current debt management environment results in serious consumer detriment and provides sub-optimal returns to creditors

(a) Consumers are paying fees well in excess of the reasonable costs of providing debt management services.

(b) The quality of advice actually provided to consumers is often poor.

(c) Creditors are mistrustful of the debt management sector as a whole, feel unable to distinguish between good and bad providers and as a consequence are increasingly charging interest to consumers in genuine financial difficulty to mitigate the costs of inappropriate arrangements.

2. There is an opportunity to use the Tribunals, Courts and Enforcement Act 2007 (the TCE Act), with only very limited changes, to bring about an environment in which consumers can be confident they are getting good quality advice whichever provider they use and creditors can trust the repayment proposals made to them and offer appropriate support and interest-charging concessions to consumers in genuine financial difficulty.

3. Each year consumers pay in the order of £250 million in fees to debt management companies which reduces the repayments they are able to make towards their debts. Allowing all providers access to the "fair share" model of funding debt management (and preventing them from making any additional charges to consumers) would make this a free service for consumers and increase returns to creditors by approximately £150 million per year.

Background

The extent of consumer debt problems

4. At any time up to 5 million individuals report: arrears on consumer credit; failure to keep up with their mortgage payment obligations; or that meeting their credit commitments is a "heavy burden". Of these, only one in six seeks advice from any other source.[86]

5. People in debt often believe that their situation is commonplace, a normal part of life. They probably know people in similar situations.

6. Although debt is unpleasant, consumers are likely to have lived with it for years. They are reticent about moving into a new way of managing money (status quo bias) especially as they perceive that getting help may involve significant loss (house, car or even relationships).

7. They are unrealistically optimistic about their future prospects. This is probably what got them into difficulty in the first place. Even when they seek help they do not generally look for long term solutions, they are more interested in short term fixes.

About Payplan

8. Payplan is a major provider of telephone based debt advice and solutions—including "free to consumer" debt management plans funded by voluntary "fair share" contributions from the credit industry. This year we will advise over 100,000 overindebted consumers. We are a Money Advice Trust partner agency and work closely with other providers within the free sector such as Citizens Advice Bureaux and National Debtline.

Context

Why engaging with the debt management sector can currently present a high risk for consumers

9. Whilst consumers get used to living with debt many are moving quickly to a situation where intervention is inevitable. Our average client has a net household income of £2,100 per month at the point they contact us and commitments (including minimum contractual debt repayments) of £2,900 per month. They are either doing without basic essentials (food, fuel etc) or their debts are increasing by £800 per month. Put another way, each month they delay seeking advice extends their debt repayment term by three months. In hindsight most of our clients dearly wish they had called us much sooner than they actually did.

10. Because people in debt delay getting advice until they feel in crisis they look for "first aid" rather than a long term solution. They want payments reduced to affordable levels and someone to deal with their creditors. They do not generally focus on the longer term, and probably do not want to think about the many years of debt repayment that may lie ahead. For providers, addressing these immediate fears can be much more profitable than actually helping to get them out of debt.

11. A provider who gives consumers unrealistically high expectations about the speed of setting up a debt management plan (DMP), the degree of creditor co-operation and sets repayments at a level that is very comfortably affordable (because they are stretched over a long period of time) will convert a high proportion of leads to business.

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[86] Office of National Statistics *Wealth and Assets Survey.*

12. A provider with a low conversion rate will not be able to pay as much for a lead (either to a "lead generator" or through direct marketing costs) and so will lose market share.

13. A provider with a high conversion rate is likely to be profitable even if many of their plans fail at an early stage, as they all too often do.[87]

14. Because of these commercial drivers there is an increasing focus amongst providers on "first aid" rather than debt resolution. In many instances, the marketing material issued by providers is targeted towards vulnerable debtors, offering instant but often unsustainable solutions. For example, phrases such as those listed below are used with little or any qualification on the websites of providers.

(a) "Debt problems? Our debt management plan helps 1000s of people get out of debt."

(b) "We'll talk to your lenders on your behalf, asking them to accept lower payments."

(c) "We'll handle all letters and phone calls from your lenders. All you do is make one monthly payment, and leave the rest to us."

15. Providers taking this approach increase their market share at the expense of those who do not. Consumers who have a bad experience with one provider are less likely to engage with another. The result of this is that many more consumers than necessary are ending up in the Collections & Recoveries Departments, of creditors feeling that debt management is not the answer. This seriously limits opportunities and economic activity for the individuals concerned and, given the extent of consumer over-indebtedness, has a wider impact on society in general.

Free debt management and solution providers

16. The free-to-consumer advice sector has an alternative offering—a creditor-funded DMP whereby the consumer pays no fee, yet receives the same (or most likely far better) help and on-going support than that offered by fee-chargers. These arrangements tend to be much more sustainable and, because they are fee free, offer a quicker route out of debt for consumers. Fee-chargers are currently unable to access this alternative model since it requires creditor support on a provider-by-provider and creditor-by-creditor basis.

Debt management fees

17. Fees charged to consumers vary but typically a provider will charge an initial set-up fee equivalent to the first two repayments and the application of an ongoing management fee of 17.5% on further repayments. Increasingly additional charges are made for things like annual reviews and the variation of payment levels.

18. With an average DMP repayment level of £300 per month, set-up fees are likely to be in the region of £600 and year one management fees £525. By way of contrast Payplan and the Consumer Credit Counselling Service (CCCS) operate the "fair share" model under which 100% of repayments go towards debt reduction and those creditors who support us pay a percentage of funds distributed to them. Because not all creditors support Payplan and the CCCS (even though both manage debts for non-supporting creditors) fees under the fair share model in this example are likely to be as low as £288 in year one with no front-loading. Furthermore, fee-chargers have de minimis fee levels which allow them profitably to sell their services to people with low repayment levels—Payplan does not. Despite this Payplan is able to cover the costs of setting up and running DMPs on this substantially lower fee structure.

Why is the current regulatory provision insufficient?

19. Providers of DMPs must hold a consumer credit licence. They are also meant to comply with the Debt Management Guidance issued by the Office of Fair Trading (OFT), although the organisation lacks the resources proactively to monitor compliance. The OFT did, however, undertake a review of the sector in 2010[88] which identified widespread problems.

20. Despite this guidance being in place for over a decade and most providers belonging to a trade body established to uphold standards (the two main trade bodies are the Debt Management Standards Association—DEMSA—and the Debt Resolution Forum—DRF), the OFT issued formal warnings to 129 of the 172 firms it surveyed—informing them that they faced losing their consumer credit licences unless immediate action was taken to comply with its Debt Management Guidance. The OFT found widespread evidence that "frontline advisers working for debt management companies are lacking in competence and are providing poor advice based on inadequate information." Since then a number of firms have surrendered their licences.

21. Restricting/controlling the marketing and operations of providers via the OFT's Debt Management Guidance, particularly following publication of the compliance review, has helped improve transparency about fees somewhat and made advertising more balanced, although there is still little evidence that this has improved the quality of advice provided. Without adjusting the commercial drivers—particularly the front-loading of fees—Payplan does not believe that OFT intervention can have a significant effect on the path chosen by consumers and the poor outcomes that result from those choices.

[87] An independent review of the fee-charging debt management industry July 2009—Money Advice Trust http://www.infohub.moneyadvicetrust.org/content_files/files/mat_report_final_v4_exec_summary.pdf

[88] . http://www.oft.gov.uk/news-and-updates/press/2010/101–10

22. Given the lack of resource to police adherence to its own Debt Management Guidance the OFT has encouraged self-regulation amongst companies within DEMSA and DRF membership, but it would be easy to comply fully with all existing codes of practice and still operate a model which focuses on high conversion rates at the acquisition stage and invests little in long term client support.

23. Increasing awareness of free and ethical advice has been of some help, but making the messages sufficiently compelling to overcome those put out by those providers with more questionable business models is a challenge. There is also a fear that, if that awareness-raising exercise were too successful, free-to-consumer providers would be swamped by the demand for advice and support.

Payplan's Recommended Solution

Introduce an independent audit that everyone (consumers, creditors and Government) can trust

24. To improve initial advice—which is key to ensuring successful outcomes—Payplan considers that providers should be required to undergo a regular audit by an "approved" auditor to standards set by an independent body or committee.

25. The audit would focus particularly on whether advice was given in a balanced way (because it is very easy to steer consumers down a particular path) and whether the assessment of consumer circumstances (in particular income and outgoings) was thorough, accurate and consistent across providers. The audit would be substantially "tougher" than any of the current codes of practice which, in our view, give providers too much latitude to set up inappropriate arrangements.

26. The cost of this audit (which would be proportionate to the size and general level of compliance of the operator) should be borne by the provider. Audit findings would be sent to the OFT (or its successor) and used in determining the continuing fitness of an operator to hold a consumer credit licence.

27. An audit should have two key components:

(a) an "objective audit" linked to the OFT's Debt Management Guidance

This would be an audit similar to the mystery shopping template used as part of the OFT compliance review, whereby a sample of cases are closely checked against a set of debt advice process steps/criteria/indicators set out in the Debt Management Guidance. An example of such an audit in current practice is the Independent Quality Assessment of Legal Services.[89]

(b) a "subjective audit" linked to a new Code of Debt Management Ethics

This would involve an auditor assessing whether a consumer has been unduly influenced through a contrived manner, tone or behaviour or as a result of the provision of inaccurate/ partial information to choose or dismiss a particular solution during the advice process. The benchmarking for this type of "subjective" audit opinion will be contained in a Code of Debt Management Ethics.

28. The auditor would determine whether providers were compliant in both of these areas. If not, and the breach was capable of straightforward remedy, then a short period would be allowed for remedial action to be taken, but then the report would be sent to the OFT with providers that continue to flout the rules being individually identified on the OFT website. It would then be for the OFT to use existing enforcement powers to deal with non-compliant providers.

Appoint an independent auditor

29. The Audit Commission practice is to prescribe and publish transparent auditor policies[90] that ensure effective external auditing functions for public services are available and can be procured for outsourcing purposes. Payplan considers that the OFT could adopt the same practice to facilitate the appointment of a skilled and experienced organisation to conduct the objective and subjective audits outlined above at a competitive price, eg

(a) An OFT-approved Statement of Debt Management Auditors' Responsibilities.

(b) An OFT-approved Code of Debt Management Auditors' Ethics.

30. These two documents would outline the essential skills requirements expected of a provider if it is to undertake an effective and independent audit. They would also define the audit and reporting scope. Audit fees would be paid for by individual providers, would be proportionate to the size of the organisation and general level of compliance and set out in a transparent fee policy.[91]

[89] Independent Quality Assessment of Legal Services
http://www.legalservices.gov.uk/docs/cls_main/Improving_Quality_Debt_Guide.pdf

[90] Audit Commission—audit regime
http://www.audit-commission.gov.uk/audit-regime/codes-of-audit-practice/Pages/default.aspx

[91] Audit Commission—audit fees
http://www.audit-commission.gov.uk/audit-regime/audit-fees/Pages/default.aspx

Control of fees charged by DMP providers

31. Consumers seeking advice are usually operating in a stressful environment and are unlikely to shop around on price,[92] consequently fee levels have significantly outstripped inflation in recent years. High set-up fees make it commercially viable to establish arrangements that are almost certain to fail. Competition for leads pushes up advertising costs and allows providers who charge higher fees to grow at the expense of providers charging lower fees. A cap on fees or, ideally, a requirement to fund DMPs solely using the "fair share" model (which would be made available to all providers) would align the interests of providers, creditors and consumers as well as—ultimately—Government.

Alternative suggested by some fee-chargers—Introduce an audit process, but do not limit fees

32. Instead require better price transparency and encourage consumers to shop around on price.

33. Payplan does not believe that increased price transparency would make a significant difference. Providers already publish their fees in fairly accessible areas of their websites yet those charging them at the higher end of the range continue to expand their market share. Although some consumers shop on price, most do not—and so advertising expenditure would need to remain high in order to retain market share.

34. There would still be a commercial incentive to charge set-up fees to as many people as possible rather than invest in high levels of support for existing clients. By contrast, an environment where it was profitable only to set up arrangements which worked over the longer term would align provider interests much more closely with those of consumers and their creditors.

35. Almost the worst case scenario would be to require providers to undergo an independent audit against one of the current self-regulatory industry codes of practice. This would simply give greater legitimacy to providers, whilst doing little to address concerns around the conflict between commercial incentive and best advice, and very probably result in increased fees as audit costs were simply passed on to consumers.

Introduce certainty of repayment term

36. Although creditors do not generally have confidence in the repayment proposals made by many providers it is not commercially feasible to challenge individual plans that are being proposed as they lack evidence to counter the information presented to them. Consequently creditors feel compelled to accept proposals but increasingly charge consumers interest on their debts.

37. Payplan is of the view that if creditors had confidence that providers were giving suitable advice, only allowing consumers who were in genuine financial difficulty access to DMPs, and setting repayment rates at an appropriate level, they would be far more willing to suspend interest charges and any enforcement action being considered. This would give consumers some certainty about their repayment term and incentivise them to maintain payments into their DMPs over the whole of the repayment term. Creditors would then have reduced collection costs and faster debt repayment. Creditor support for this policy could be voluntary (for example by incorporating it within The Lending Code) or mandatory (perhaps by making this a condition of their consumer credit licence).

Stakeholder benefits

38. Were these three interlinked strands adopted, consumers could approach any provider and have confidence that they were receiving balanced advice and good quality solutions, confident that they were not risking being ripped off through the charging of excessive fees.

39. Competition would stop being about advertising expenditure and the inevitable link to set-up fee levels (often precisely to fund such marketing) and start being about quality of service. The companies that thrived under this regime would be those able to offer good service levels throughout the life of the arrangement rather than those whose objective was simply to entice consumers into DMPs that had no realistic prospect of long term success.

40. DMPs would be much more likely to lead to debt repayment than at present, genuinely resolving debt problems for the majority of consumers who entered them. This would be achieved at far lower cost than under the present regime and significantly increase the speed at which creditors were repaid.

41. It might be worth noting that this scheme only works if it is commercially viable for those fee-chargers who want to provide a good service at a reasonable cost without set-up fees to make the transition from the current free-for-all high fee environment to a more socially responsible one. It would be important therefore to have a managed transition, perhaps by phasing in new fee structures over a period of time.

[92] An independent review of the fee-charging debt management industry July 2009—Money Advice Trust http://www.infohub.moneyadvicetrust.org/content_files/files/mat_report_final_v4_exec_summary.pdf

Mechanism for Bringing About Change

Analysis of deficiencies

42. From the above discussion, it will be apparent that the principal weaknesses in the present arrangements are as follows:

(a) The targeting of vulnerable consumers who may often be unaware of the alternative forms of free to debtor advice which may be available.

(b) The levels of fees charged and the manner of charging them.

(c) Ensuring compliance by providers with the OFT's Debt Management Guidance.

Regulatory Structure

43. In addition to the Regulation of DMP providers under the Consumer Credit Licensing Regime, there exists also Part 5 ("Debt management and relief") of the TCE Act. Part 5 provides for the setting up of a regulatory regime in respect of DMPs. Certain broad principles are set forth in the Act itself, but the detail is to be filled in by way of Regulations. In particular, section 113(1) of the Act provides for a debt management scheme to have effect subject to "relevant terms" which are defined in section 113(2) as including (a) terms (if any) specified in Regulations that relate to the approval. Such terms may be imposed upon the scheme operator (section 113(4)). The Minister responsible for the making of Regulations is the Lord Chancellor (Section 130 (1) of TCE Act).

44. In terms of section 129, the Supervising Authority is the Lord Chancellor or any person authorised by him to approve debt management schemes under section 111. As Part 5 is not yet in force, no such appointment has yet been made. However, under the Consumer Credit Act 1974, debt management companies are currently licensed (and thus supervised, albeit fairly loosely) by the OFT, and since the Office has developed expertise in this area, it may well be that it would be appropriate to appoint the body to continue acting as the supervising authority under Part 5 of the TCE Act.

45. This opens up the possibility of regulations being made under section 130 having the purpose of imposing mandatory requirements upon operators that would need to be met to the satisfaction of the OFT before a scheme could be approved.

46. Although the Bill that became the TCE Act received Royal Assent on 9 July 2007, no Commencement Order has yet been made in respect of Part 5, and, consequently, no Regulations have been promulgated under it to date.

47. Were a commencement order now to be made, that would permit the making of appropriate regulations. How such a mandatory regulatory scheme might work can be seen in the analogous provisions of Part 1 ("The debt arrangement scheme") of the Debt Arrangement and Attachment (Scotland) Act 2002, and the current Regulations made thereunder, namely, the Debt Arrangement Scheme (Scotland) Regulations 2011 [Scottish Statutory Instrument 2011 No. 141].

48. Alternatively, were Part 5 of the TCE Act not to be brought into force, then it might be possible to go some way towards addressing the issues by way of the introduction of updated Debt Management Guidance, published by the Office of Fair Trading pursuant to its powers under section 25A of the Consumer Credit Act 1974 ("the CCA"). In the event that the DMP provider proposed to operate its business in a manner inconsistent with that guidance, it would be a basis for the OFT determining under section 25 of the CCA that it was not a fit and proper person to hold a licence. In the event that the operator failed to follow the Guidance that would justify the OFT being minded to withdraw their consumer credit licence.

49. Indeed, even in the case of implementation of Part 5 of the TCE Act, there may be scope to consider whether it would be more appropriate to make certain requirements mandatory as part of the regulatory regime under that statute, whilst others were made the subject of amended Debt Management Guidance issued under the CCA.

50. Whichever regulatory route were taken, it would, however, be necessary to make one minor amendment to the primary legislation, (Part 5 of the TCE Act) to enable the proposals contained in this submission to be implemented, as explained below. Subject to this one minor amendment, Part 5 the TCE Act (if implemented) would enable the creation of a framework by means of the projected Regulations and amended Debt Management Guidance, under which the three deficiencies outlined at the head of this section could be addressed.

Fee-Charging Models

51. As currently drafted, section 124(1) of the TCE Act provides

(a) "The operator of an approved scheme may recover its costs by charging debtors or affected creditors (or both)."

52. and Section 124(2) provides:

(a) "costs means the costs which the operator incurs, taking one year with another, in connection with the approved scheme, so far as those costs are reasonable"

53. It will be seen that this would permit charging models in which costs are recovered from either the debtor or the creditor, but it is understood that there is some ambiguity over the use of the word "costs", in particular whether that permits the making of charges which include a reasonable level of profit or whether it is limited to recovery of actual costs excluding any element of profit. Although there is a charitable sector, it is very small and unlikely to be able to cope as the sole providers of DMPs and there is clearly a market need for the fairshare model.

54. In these circumstances, the sole amendment which Payplan would suggest to the primary (though as yet unimplemented) legislation would be to clarify the provisions relating to costs in the following manner:

(a) Section 124(1) should be amended to provide:

(b) "The operator of an approved scheme may recover its charges by charging debtors or affected creditors (or both)."

(c) and section 124(2) should be amended to provide:

(d) "charges means the costs which the operator incurs, taking one year with another, in connection with the approved scheme, along with any charges made by the operator, so far as those costs and charges are reasonable."

55. The Financial Services Bill or perhaps some other draft primary legislation emanating from the Department for Business, Innovation & Skills might conveniently provide the legislative vehicle through which the minor changes to section 124 of the TCE Act proposed above could be effected.

56. If the route of amending the TCE Act were taken, the Regulations made under it so far as they related to charges and costs could simply provide:-

(a) "Charges by approved operators

(a) An approved operator shall not impose charges by way of costs to the debtor and/or affected creditor under section 124(1) of the Act which are greater than either:

(1) []% of the relevant debt; or

(2) £[], whichever is the smaller."

57. Alternatively, the Regulations could make provision for specific fees and charges according to a table of fees set out in a Schedule to the Regulations. This would allow them to be varied periodically to account for changes in the cost of providing debt management services.

Audit Requirements

58. The ultimate guarantee of effectiveness of these proposed reforms is the introduction of an audit regime as discussed earlier in this submission/ It may be possible for such auditing requirements to be mandated by regulations made under the TCE Act via section 113 (5) and Schedule 21 paragraph (1) (b) thereto, which permits second legislation to be made concerning the governance of the scheme operator. It may, however, be that this aspect of regulation would fit more comfortably within revised Debt Management Guidance issued under the CCA.

Conclusion

59. There is presented at this time a real opportunity to improve the activities undertaken by debt management companies and to ensure a consistent standard of service for consumers is achieved. In particular, there also exists scope to address the abuses which have been identified, including by taking steps to ensure that only reasonable fees are charged by debt management companies.

60. If it is intended to bring Part 5 of the TCE Act into force, then (subject to the minor amendments to section 124 outlined previously), these significant improvements could be achieved for consumers within the minimum regulatory regime that would be necessitated as a result of bringing Part 5 into force. Alternatively, similar results could also be achieved without any significant undue regulatory burden by means of revising the Debt Management Guidance issued under the CCA.

14 November 2011

Supplementary written evidence submitted by Payplan

Response to written questions from the Business, Innovation and Skills Committee

1. [to DEMSA and DRF] *What have you done since the OFT investigation to improve standards in your industry? What evidence do you have of improvements?*

2. [to DEMSA and DRF] *How many firms have broken your trade association codes in the last 12 months? What action have you taken against them?*

3. *Last week we heard that there needed to be much more transparency in the commercial debt advice market—would you agree? Do you currently publish figures on, for example, the number of people you recommend an individual voluntary arrangement or debt relief order? If not why not?*

We very much agree. We currently share data with relevant organisations (creditors, other advice providers, researchers etc) and believe it would be of value to require all providers to publish key information.

Experience within the free sector where we have shared data over several years leads us to strongly recommend that any requirement needs to be carefully worded to ensure a true like for like comparison. It is also worth noting that the general client profile and therefore outcomes will vary between providers. This will particularly be the case for organisations who target advertising at particular types of consumer, or who operates by paying a third party for "leads" of a particular type of client.

Any requirement to publish data should include a requirement to publish data on the sustainability of arrangements.

4. *What percentage of your debt management plan customers are still making their debt management plan payments after 24 months?*

82% are still in their DMP, 1.75% have switched to an IVA, 3% have left because their circumstances have improved and the remaining cases have failed, either because circumstances have deteriorated or the client has stopped paying and we have been unable to make contact.

5. *Do you make people who contact your organisations aware of the availability of free debt advice? Should you?*

Not sure this is relevant to us as a free provider.

6. *Do you educate people who come to you about financial planning and budgeting so they are better able to manage their finances in future? Do you think there is capacity for you to do more of this?*

Our advice process involves helping our clients work out a realistic budget and, for those who enter into a DMP we provide ongoing support in managing their budget. We are not authorised to give advice on pensions etc but have a reciprocal referral arrangement with the Money Advice Service whereby we can direct clients to them for help with these matters and they can direct customers approaching them with debt problems to us. Our own staff are able to help with non-regulated advice such as benefits entitlement and utility switching which can help free up additional income.

It would be feasible for us to give our clients additional help on financial planning and budgeting—particularly for those who do not enter a repayment arrangement. We would in principle be happy to undertake additional work but we are not currently funded to do so.

6 December 2011

Supplementary written evidence submitted by Gregory Pennington

GREGORY PENNINGTON'S RESPONSE TO BIS SELECT COMMITTEE ON FOLLOW UP QUESTIONS

Introduction

- Gregory Pennington has been providing debt advice and access to a range of debt solutions for almost 20 years.
- All advice is provided without charge and only approximately 9% of enquires—having received advice—go on to pay for an ongoing debt solution.
- We have developed a free self help booklet and website (www.debtandyou.co.uk) which provides budgeting advice, hints and tips, income maximisation and benefit assistance, as well as downloadable guides and letter templates—all of which are provide without charge—for those individuals that are confident enough to self manage their debts. Within the last year, over 10,000 people utilised the support and guidance provided through this website.

— We are one of the few private providers approved by the Secretary of State as a Competent Authority, allowing us to accredit Intermediaries who in-turn are able to provide clients (where appropriate) with access to debt write-off through the Debt Relief Order. This service is provided completely without charge.

— Ensuring most appropriate advice and access to right solution has always been our approach, which is why we offer our clients access to every available debt and insolvency solution.

— Gregory Pennington is also one of only four organisations to be approved by the Accountant in Bankruptcy (an executive Scottish agency) to provide Payment Distribution Services in connection with the Debt Arrangement Scheme.

— We currently work with circa 50,000 people, providing them with debt management and budgeting services on an on-going basis.

— Despite improving our services and providing extended assistance to our clients through the introduction of additional budgeting tools, negotiation of secured and priority bill arrears, income maximisation and the development of a web based support service; we have chosen not to increase our fees and we remain one of the lowest in the sector—charging the equivalent of one month's disposable income as an initial set-up fee and then 15% per month on a pay as you go basis.

— Having commissioned independent market research, we identified that our clients typically had awareness of the free-to-client sector; however actively chose to use our services, because they felt that we represented real value for money and they appreciated the additional support and professionalism of the services we provided.

— Prior to any client instructing us to commence work for them; we outline clearly and transparently what service they can expect to receive from us and not only the initial cost—but the total fees throughout the duration of the DMP are provided in writing. Once a client makes an initial payment to us, they have a 14 day cancellation period, to further consider their options—during which time, a full refund of their payment will be made (without any charge being made) should they change their mind. We are therefore confident that our clients make an informed decision to work with us and we in-turn work hard to meet their expectations on their journey to becoming debt free.

— DEMSA, our trade body, conducts independent customer satisfaction surveys across 10% of our database, representing a mix of clients at different stages of their DMP. In the quarter to September 2011, 86.8% of our clients rated us as good or excellent.

Last week we heard that there needed to be much more transparency in the commercial debt advice market—would you agree? Do you currently publish figures on, for example, the number of people you recommend an individual voluntary arrangement or debt relief order? If not why not?

We absolutely agree that there needs to be more transparency and protection for financially distressed individuals. However we believe that every client is entitled to any advice and assistance being provided to them with a "duty of care" as, regardless of whether or not the service attracts a fee, poor advice can and most likely, will result in consumer detriment—which may not simply be financially calculable—but in a more extreme case—could involve loss of home or liberty. We would therefore like to see every individual or organisation offering debt advice and/or ongoing services being accredited and independently audited.

We also believe that the sharing of data across the sector would be a positive move and one which we would fully support. Not only would this allow for a better understanding as to how many individuals are utilizing informal DMPs, it could also provide greater insight into whether or not consumers felt this provided them with a positive outcome and, in particular, could help to determine which service providers were performing better and why.

Of the 150,000 people that we speak to and provide advice to in the course of a year, only approximately 9% go on to take a debt solution for which there is a fee. This splits down as follows:

60% Debt management plan

23% Individual Voluntary Arrangement

6% Trust Deed (Scottish residents only)

5% Debt Arrangement Scheme (Scottish residents only)

5% Bankruptcy

1% Debt Relief Order

What percentage of your debt management plan customers are still making their debt management plan payments after 24 months?

A common misconception is a DMP that finishes prior to the repayment of all of the clients' debts is a failure. Whilst this may be the case on occasions, many clients utilize a DMP for a variety of reason—never intending to remain on their Plan for the longer term. This may be due to an unexpected income shock, lack of budgeting or money management confidence (perhaps driven by lender pressure) or in some instances, because they have been unable or are unwilling to access a more appropriate formal solution, such as bankruptcy or an IVA. Unlike formal insolvency solutions, DMPs allow flexibility and do not require the sacrifice of assets, such as the family home, as bankruptcy or an IVA might.

Broadly, once a client has commenced their DMP, there are a number of scenarios:

- We negotiate with lenders and they agree to support the level of repayment proposed and to provide concessions in relation to interest and charges. The client works within their budget, meets the payments due until they become debt free.
- Their circumstances improve and they resume contractual repayments.
- After budgeting advice and support and following the acceptance of concessionary arrangements, some clients feel confident enough to deal directly with their lenders and continue their DMP directly.
- Sadly in some cases, clients experience a further deterioration in circumstances, resulting in the DMP becoming unviable and a different, more appropriate solution being needed.
- Legislation may change. For example some clients may have been suitable for a DRO but their accrued pension rights prevented them from taking one. The DRO pension rules have now changed so some clients may become eligible.
- Some may not be willing to accept that their best option is a debt write off solution and may take time to accept the severity of their situation.

Overall just 2.6% of our clients leave their DMP each month. Of the clients leaving their DMP:

20% leave debt free

24% have a change in circumstances, warranting an alternative solution

22% leave, feeling empowered to deal directly with their lenders

20% circumstances improve

10% move to another provider

4% for other reasons, typically specific to their individual circumstances

Do you make people who contact your organisations aware of the availability of free debt advice? Should you?

We don't believe there is a lack of awareness amongst consumers of the free services available. Indeed the National Audit Office found last year that 97% of people with debt problems were aware of free advice agencies. We believe the Citizens Advice Bureau is one of the most highly regarded and best known brands in the UK. It is also important to note that every lender is required, as part of their responsibilities under the Consumer Credit Act, to provide customers who go into arrears with a copy of the OFT's Information Sheet—which details a number of free to client advice providers; which includes, amongst others, Citizens Advice, Consumer Credit Counselling Service and National Debtline.

The OFT's Debt Management Guidance also requires all firms to display and signpost to the Insolvency Service's advice guide "In Debt? Dealing with your creditor"—which is provide as a link and downloadable guide on our website.

It is interesting to note that the Scottish regulator—the Accountant in Bankruptcy—introduced regulatory changes in July this year; which requires all private firms to not only advise explicitly of the availability of free advice (in relation to the Debt Arrangement Scheme); but also to provide all prospective clients with details of their nearest free money adviser—specifically their location details. In our experience, despite being provided with this information—which is prescriptive to meet regulatory requirements—the vast majority of clients are either already aware of this or choose not to pursue this route.

Do you educate people who come to you about financial planning and budgeting so they are better able to manage their finances in future? Do you think there is capacity for you to do more of this?

Yes. Most debt solutions require people to work within a reasonably restrictive budget; for a significant amount of time, in order for these solutions to be successful. It is therefore imperative that we work with our clients to help them draw up a realistic budget; that takes account of priority bills (including arrears) as well as day to day living expenses. This approach includes reviewing any benefit entitlements; thereby maximising the income—as well as reviewing cheaper utility tariffs and discussing money saving hints and tips. Whilst a significant proportion of our clients may have suffered a change to their circumstances, resulting in an inability to meet their unsecured contractual obligations, better budgeting skills can only help make their Plan more likely to succeed and assist them with any future money management.

In addition to this, we work with our clients on a daily basis to address any difficulties they experience in adhering to their budget, which will include regular periodic reviews, as well as changes to payment amounts, to reflect any changes to their financial circumstances.

Some Further Information we believe the Committee may find useful

Simplified Individual Voluntary Arrangement (SIVA)

The Insolvency Service consulted and looked set to introduce a SIVA; which aimed to reduce creditor voting powers to a simple majority, with deemed consent, rather than a required response and the removal of modifications—thereby requiring the creditor to either accept or reject the terms—without unnecessary and costly changes. Despite the introduction of the IVA Protocol, we still believe there is a place for SIVA, which would allow more consumers to gain access to much needed and appropriate debt write-off; whilst removing some of the associated and unnecessary costs.

Enforcement Restrictions Order (ERO)

The 2007 Tribunals, Courts and Enforcement Act legislated for the introduction of EROs; which effectively allowed a personal suffering an income shock or unexpected change in circumstances, to be protected from creditor enforcement action for a period of up-to 12 months whilst their circumstances improved. Again there is a place for EROs; which may well have stopped some individuals from having to seek a potentially unnecessary debt solution—where simply some "breathing space" would have been more appropriate—free from the threat of enforcement action, unnecessary collection charges or the seeking of preferential treatment by some lenders.

Regulated Debt Management Plans

Within the same Act as EROs, legislation was provided for the introduction of regulated DMPs. Whilst there would have been significant benefits to the enactment of this legislation; there would too have been some unintended consequences. Benefits of the Act included the ability to make regulated DMPs legally binding upon all parties, but in particular brought additional restriction on creditors—thereby preventing them from collection or enforcement of their debt (for as long as the Plan conditions were met) whilst restricting them from the application of interest or charges—thereby preventing debts from growing and giving the consumer protection and much needed certainty.

However the consequence of regulating a DMP, was that it did not ensure that the DMP was the best solution for the consumer and did not prevent inappropriate behaviour from the provider; who may simply choose not to offer any regulated Plan—opting instead for only informal DMPs. Whilst we believe the certainty of a regulated Plan would bring many benefits for consumers; we firmly believe this needs to be aligned with regulation or accreditation of the debt solution provider too.

Debt Arrangement Schemes (DAS)—Debt Payment Programmes (DPP)

We believe there are many aspects of the DAS that work very well, addressing many of the deficits outlined above. DAS is, in effect, a regulated DMP for Scottish residents—with five parties involved being: The consumer, the DAS Administrator (AiB), the Money Adviser, the Payment Distributor and the creditors. Legislation has been reviewed and revised several times; hence it today contains many of the benefits we have outlined above. DAS works on a deemed consent basis, so only objecting creditors need to respond. All approved DPPs are legal binding; protecting the home, preventing enforcement and removing all future interest and charges.

Interestingly there is a mix between private and public sector providers; with some Money Advisers charging for their service and some providing it for free. Changes to DAS regulations in July were introduced to widen access via the private sector—accrediting their Money Advisers to Continuing Money Advisers—which effectively allows for an ongoing service to be provided beyond the commencement of the DPP. At the same time, the role of the free to client provider was reduced to the assessment and proposal of the DPP, with the ongoing management becoming the responsibility of the DAS Administrator. This change provided for free advice and free access where needed or preferred, but also allowed for the consumer—who is prepared to pay and values the support of a professional DPP provider—to make an informed choice. Since the introduction of this change on 1 July 2011, DPPs have increased by approximately 45%.

The Payment Distributor service is also provided by the private sector, following the tendering and outsourcing of this role. Legislation however dictates that creditors must pay for this service and prohibits any charges from being made to the consumer. Legislation further restricts the amount that can be charged—in percentage terms and levies a fee on every payment received, which is payable to the DAS Administrator (Accountant in Bankruptcy) thereby making DAS completely self funding.

9 December 2011

Written evidence submitted by Provident Financial Group plc

1. Provident Financial Group

1.1 Provident Financial Group is one of the UK's leading suppliers of personal credit products to the non-standard lending market, serving over 2.4 million customers.

1.2 Provident Financial has been serving customers since 1880. We operate solely in the non-standard credit market in the UK and Republic of Ireland.

1.3 Our business is split into two divisions: our Consumer Credit Division and Vanquis Bank. The Consumer Credit Division offers home credit—small, unsecured loans issued at the customer's home by a local agent of the company and repaid weekly. Vanquis Bank offers Visa credit cards, bringing the benefits of credit cards in a controlled way to people who can find themselves excluded by mainstream card issuers.

1.4 Our products have been tailored to meet the specific needs of our customers. We provide our customers with small-sum products that are straightforward and easy to understand, that are affordable and that offer high levels of flexibility and personal contact. This is the approach to lending we have taken for over 130 years and is one of the reasons we're able to achieve consistently high levels of customer satisfaction.

2. What home credit is and how it works

2.1 Home credit has the following key characteristics:

- Uniquely—and different to other forms of lending including payday lending—there are *no penalty fees or extra interest for late or missed payments*. The total amount payable, including interest, is fixed. Each pound repaid by the customer brings down the total amount owed by a pound. The amount owed by a customer cannot "spiral" out of control. *This control and certainty is hugely important for, and valued by, people on lower, fixed or variable incomes.*
- Any concerns about the so-called "rollover" of a loan (when a customer is unable to repay and is issued another loan) do not apply in the case of home credit. *When a customer cannot pay, home credit's response is to show forbearance. Typically repayments are reduced or suspended (at no extra cost)* until the customer is able to resume payments at the initial contractual rate.
- *Loans offered are small*—typically in the range of £200 to £500. Lower income borrowers typically want to borrow relatively small amounts.
- They are *short term and unsecured*, usually for a year or less.
- All would-be borrowers are individually assessed in person, rather than by remote or automated means.
- Also uniquely, loans are granted and repayments collected from customers at home. The majority of both customers and home credit agents are women.
- Unlike other lenders, repayments are collected on a weekly basis, making the amounts collected small and manageable, while also matching lower income household budgeting cycles.
- Home-based service is key to this form of lending. Customers value it as it offers access, convenience and penalty-free tolerance of missed payments. Attempts at remote repayment models have been shown to be unviable.
- *Home credit is not a source of consumer complaints or indebtedness*. Figures from the Consumer Credit Counselling Service show home credit accounted for 0.4% of problem debt they saw in 2010.
- *Home credit accounts for just under 1% of unsecured lending in the UK.*

3. The Needs of Borrowers on Lower Incomes

3.1 Lower income borrowers often look for specific things when seeking credit and the features they prioritise may differ from what higher income consumers would consider most important. A 2005 report commissioned by the Joseph Rowntree Foundation, entitled "*Affordable credit for low-income* households",[93] identified what people on lower incomes look for when they borrow. Their key needs include:

Affordable repayments—borrowers want small, affordable weekly repayments that can easily be accommodated in their household budget. They may want to make smaller but more frequent payments, typically weekly, because this fits in with their weekly budgeting pattern.

A suitable, flexible repayment method—the ideal method would be one which is regular and convenient but which can also offer flexibility. It would make it as easy as possible for customers to pay when they could but wouldn't penalise them when they couldn't.

Transparency—with the total cost fixed and clear upfront. This means no hidden charges emerging after the credit agreement is signed, typically in the form of late or missed payment penalties.

Access—quick, convenient access without an overly long or intrusive application process.

[93] www.jrf.org.uk/publications/affordable-credit-low-income-households

3.2 Unless a credit provider can match these requirements the credit offered will not meet the needs of lower income borrowers. Home credit matches all of the above requirements of lower income borrowers. Dame Deirdre Hutton, when Chair of the National Consumer Council, summarised the home credit product and service:

> "Home credit offers a unique service—there's nothing else quite like it. Small, short-term unsecured cash loans, perhaps for as little as £100, are a lifeline to people on long-term low incomes who are excluded from the mainstream credit market. When they need extra cash for household bills, their child's school uniform, or to cope with the financial demands of relationship breakdown, a new baby or sickness in the family they turn to the friendly agent who calls every week. The deal is done quickly, informally and face-to-face with local collectors who may have been known to the family for generations. Trust, flexibility and fixed weekly payments—with no penalties for missed payments—are the hallmark of a service that fits the needs of this vulnerable group like a glove."

4. Why Some APRs and Total Cost of Credit Appear High Compared with "Mainstream" Loans

4.1 APR is an *annualised* percentage rate. This means that the formula set down in legislation has the effect of creating ever higher APRs the shorter the term of the loan. Experts agree that APR isn't a good indicator of value for shorter term, small loans. As Martin Lewis (MoneySavingExpert) put it to the Treasury Committee (and in similar terms to the BIS Committee on November 22 2011):

> "I did a pet calculation the other day which showed that if I lent you £20 and said, 'Pay me back a pint of beer next week; buy me a pint for it,' and the pint cost £3, that's 141,000% interest, if you compound it. Yet most people would say, 'Buy me a pint and £20, is a pretty reasonable deal.'"[94]

4.2 Whether you provide a loan of £100 or £10,000 the administrative and regulatory costs are the same. For short-term small sum credit the Total Cost of Credit (the cost per £100 lent) therefore can appear significantly higher than for larger, longer term loans.

4.3 Independent research commissioned by the Joseph Rowntree Foundation demonstrated that, even with favourable assumptions, as well as costs of funding excluded, providing home credit on a not-for-profit basis would need an APR of 123%.[95]

5. Price Controls

5.1 The government and regulators have reviewed price controls on a number of occasions in recent years. The Competition Commission, the Office of Fair Trading and the previous Labour Government all considered the issue of price controls and all came to a similar conclusion—that introducing price controls could lead to unintended consequences that would be detrimental to consumers. In particular, price controls could restrict the supply of credit and force those who need it into the hands of illegal moneylenders. In its review of the high cost credit sector, published in June 2010, the OFT review concluded:

> "introducing price controls would not be an appropriate solution to the particular concerns we have identified in this market"

and that

> "developing a system to enforce and monitor price controls or interest rate caps in the UK would be complex, expensive and difficult to administer".

5.2 Proponents of price controls have only recently accepted that a cap on APR has serious shortcomings. They are now arguing for a cap on the Total Cost of Credit (TCC).

5.3 For home credit, capping the TCC is as blunt an instrument and as potentially as damaging to consumers as capping APR. This is because home credit APRs are inclusive: they must be calculated on the basis of all the costs of providing credit. Proponents of a TCC cap have so far failed to produce evidence that such a cap would not have the same impact as a cap on APR. Nor have they explained how, in practice, it would work.

5.4 Indeed, price controls based on TCC would specifically discriminate against home credit providers compared to other forms of credit, because of the higher costs of home collection. As a result it would distort the consumer credit market.

5.5 Our view is that a cap on TCC would have exactly the same negative effects as a cap on APR—ie it would exclude more people on lower incomes from accessing credit and would reduce the availability of small sum lending, thereby reducing competition and increasing illegal lending (along with the social harm that follows).

5.6 We welcome the Coalition Government's commissioning of research in this area and expect it to arrive at similar conclusions to those of the Competition Commission, the OFT and the previous Labour Government, all of whom studied these issues in depth.

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[94] http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/430/10101902.htm

[95] "Is a not-for-profit home credit business feasible?" Prof Elaine Kempson, Anna Ellison, Claire Whyley and Prof Paul A Jones for JRF, 2009
http://www.jrf.org.uk/sites/files/jrf/home-credit-business-full.pdf

6. What Others Have Said on Price Controls

6.1 While price caps might seem a simple way of reducing the cost of credit for consumers, independent research[96] has shown it can mean:

- less transparency with greater back end penalty and ancillary charges;
- lenders withdrawing from the market; leading to
  - increased exclusion for higher risk borrowers;
  - higher levels of illegal lending;
  - greater consumer detriment when in credit difficulties;
  - greater chance of complete financial breakdown for consumers; and
  - less product diversity and innovation in the market.

6.2 Some of the comments of the regulatory, consumer and money advice experts who have considered the issue of price controls:

> "…there are a number of problems associated with interest rate ceilings: The UK has a sophisticated and diverse credit market. There would be many practical difficulties in introducing a capping regime that would apply to so many different types of credit arrangement... A rate ceiling may also result in some lenders withdrawing from the market. This, in turn, may lead to groups of consumers being denied ready access to alternative forms of credit, forcing them to resort to illegal moneylenders."
> *Fair, Clear and Competitive: The Consumer Credit Market in the 21st Century, White Paper 2003*

> "We consider that price caps would have significant disadvantages in this market… We further noted that there would be considerable practical problems with the implementation of price caps."
> *Competition Commission, Home Credit Market Investigation, November 2006*

> "It would appear likely that credit exclusion will result from the imposition of a ceiling and that the consequences will include significant hardship for excluded households who will no longer be able to access small sum cash credit to manage cash emergencies or peaks of expenditure or to enable them to spread the cost of major purchases."
> *Policis, "The impact of interest rate ceilings", 2008*

> "…at this point in time, if the Government were to legislate now and put in a cap of any percentage rate for the people who were paying 700%, you would actually put a lot of those people, two or three million people who are using even just home credit for example, in a position where they would not have access to any kind of affordable credit at all."
> *Mark Lyonette, Chief Executive Officer, Association of British Credit Unions Limited, in evidence to Scottish Affairs Committee, July 2009*

> "The Taskforce believes that there is no case for introducing an interest rate cap on unsecured credit until there is an adequate alternative supply of affordable credit. Attention and resources would therefore be better focussed on improving the supply of affordable credit rather than introducing further restrictions to supply."
> *Financial Inclusion Taskforce, March 2010*

> "The research showed that imposing a cap on interest rates could result in lenders withdrawing from the riskier end of the market, including the home credit market, denying vulnerable consumers access to legitimate sources of credit and potentially forcing them to resort to illegal money lending. This was a view shared by leading consumer groups including Citizens Advice, the Association of British Credit Unions, the Institute of Public Policy Research, Which? and Advice UK."
> *Former consumer affairs minister Kevin Brennan MP, March 2010*

> "The OFT is concerned that such [price] controls may further reduce supply and considers there to be practical problems with their implementation and effectiveness."
> *Office of Fair Trading press release on publication of review of high-cost credit, June 2010*

> "…there is quite a lot of evidence to suggest that it [a cap] may drive some consumers into the hands of the illegal or less good sector... we would be concerned about some of the unintended consequences of caps."
> *Philip Cullum, Deputy Chief Executive Consumer Focus, in evidence to the Treasury Committee, November 2010*

> "We agree with the view that an interest rate cap may have unintended consequences and not provide the protection such a cap would be intended to provide."
> *Money Advice Trust submission to BIS, December 2010*

24 November 2011

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[96] Policis for DTI, The Effect of Interest Rate Controls in Other Countries, July 2004
http://www.policis.com/pdf/DTI_Effect_of_interest_rate_controls.pdf

Written evidence submitted by R3

R3 represents 97% of licensed Insolvency Practitioners and insolvency lawyers. We have focused our submission on Section 5 of the Government's response to the Consumer Credit and Personal Insolvency Review—Debt Advice and Collective Solutions for the Debtor.

Insolvency Practitioners are experts in personal insolvency and debt advice, working with financially distressed individuals on a daily basis. They provide the full range of debt and insolvency solutions, including acting as Trustees in Bankruptcy and Supervisors of Individual Voluntary Arrangements. As such, they have a unique perspective on the UK's personal insolvency regime.

We welcome certain outcomes of the Review but are concerned that the Government's proposals fail to tackle some key "problem areas"—eg bad practice in the Debt Management Plan industry. We also believe there are proposals put forward by stakeholders that have been dismissed, though there would be benefit in exploring them—eg proposals to improve the quality of debt advice.

I very much hope to be called for evidence so that I can share our members' first-hand experience of debt and insolvency in the UK and offer our views on the adequacy of the Government's response to the recent Review. In the meantime, if you would like any further information from us, please just let me know.

Frances Coulson
R3 President

Response by R3, the Insolvency Trade Body

R3 is the trade body that represents 97% of licensed Insolvency Practitioners (IPs). IPs are accountants and lawyers who specialise in insolvency. They provide the full range of debt and insolvency solutions, including acting as Trustees in Bankruptcy and Supervisors of Individual Voluntary Arrangements.

Our members work with financially distressed individuals on a daily basis so we have focused our response on Section 5 of the Government's response to the Consumer Credit and Personal Insolvency Review—Debt Advice and Collective Solutions for the Debtor.

Executive Summary

1. We welcome certain outcomes of the Review but are concerned that the Government's proposals fail to tackle some key "problem areas".

2. While there is much good practice in the Debt Management Plan (DMP) industry, particularly from providers operating under the voluntary codes, there remains considerable bad practice that must be addressed. A DMP Protocol is a step in the right direction, but it is a muted response. A Protocol is simply not capable of tackling the "bad guys" operating outside voluntary codes.

3. The Government response suggests that legislative change is needed so that the banks can provide basic banks accounts for bankrupts; yet it is possible for banks to offer these under existing legislation—as some currently do.

4. The Government response concedes that there is widespread support for a "gatekeeper" to address concerns about the quality of debt advice. We would like to see the Government consult on various models to tackle the problem of "bad advice".

5. The response recognises the disproportionate power of lenders in Individual Voluntary Arrangements (IVAs) through the IVA Protocol. We are disappointed that the Government does not intend to resolve the imbalance between debtor and creditor by introducing Simplified IVAs.

6. It is counter-intuitive that people who are hugely indebted have to find £700 "upfront" to apply for bankruptcy. Although this issue was not addressed in the Government's response, a subsequent consultation is exploring whether this cost could be paid in instalments, which we welcome. We also believe there is merit in the Government considering raising debt and asset levels in Debt Relief Orders (DROs) to widen access to debt relief for those who cannot afford to go bankrupt.

Key Terms

7. *Debt Management Plans*: DMPs are formal but non-statutory repayment plans agreed between debtors and creditors, often by a third party (who may or may not take a fee). DMPs are not binding on creditors or debtors. Some may involve a degree of debt write-off.

8. *Individual Voluntary Arrangements*: Introduced in 1986, IVAs are a binding statutory contract between debtors and creditors. It is usually a five year repayment plan involving some debt write off. Once approved by creditors, the IVA will be supervised by an Insolvency Practitioner.

9. *Bankruptcy*: Bankruptcy is a formal court procedure. It is usually entered into when an individual cannot pay their debts and does not have sufficient income to enter a repayment plan. Assets are liquidated; the individual is subject to a number of restrictions (eg limited access to credit), usually for a year; and surplus income is used to repay creditors for up to three years. Remaining debts are written off.

10. *Debt Relief Orders*: Similar to bankruptcy, these are only available for individuals with low assets and little disposable income. They were brought in during 2009 to provide wider access to debt relief for those who cannot afford to enter an arrangement with creditors or go bankrupt. The key difference between bankruptcy and a DRO is that there is no debtor's estate in a DRO—ie the OR does not realise assets or pay creditors.

11. *The IVA Protocol*: This is a voluntary code of conduct designed by a working group of IVA providers, creditors, consumer representatives and the Insolvency Service. It outlines the simple process to be followed on straightforward IVA cases.

12. *Deed of Arrangement*: A non-binding repayment plan brought into being when agreed by a simple majority of creditors. Unlike an IVA, creditors who did not vote in favour are not bound—ie they can take action against the debtor to recover what they are owed. Provisions for Deeds are contained in the Deed of Arrangement Act 1914.

13. *County Court Administration Order*: A CCAO is a repayment plan administered by the Court. Individuals can only apply if they owe less than £5,000 and have a County Court Judgement against them. Provisions for Deeds are contained in the Tribunals, Courts and Enforcement Act 2007.

Government Action

DMP Protocol

14. The Government response to the Consumer Credit and Personal Insolvency Review states that "*DMPs caused concern amongst all respondents*". As a result, they will "*continue to monitor*" practice in the DMP industry and introduce a DMP protocol. This muted response shows a disappointing failure to understand stakeholder concerns.

15. While a Protocol is an improvement on the status quo, it is not sufficient to tackle the "bad guys" who could operate comfortably outside it. R3 believes bad practice in the DMP industry should be tackled by more stringent regulation. Those providing DMPs should be regulated to the same high standard as those who provide formal insolvency procedures.

16. DMPs have an important role to play in the debt landscape and a DMP can be the right option in certain circumstances. DMPs are provided by private sector organisations, not-for-profit organisations and a small number of Insolvency Practitioners. It is critical that wherever a DMP is recommended, it is done so on the basis of full and impartial advice. While many DMP providers consider a range of solutions and only offer DMPs in the right circumstances, there is evidence to suggest bad practice and mis-selling in parts of the industry.

17. Despite the Government's assertion that there was a "*paucity of evidence stakeholders were able to provide*" in relation to DMPs, research provided by R3[97] among individuals in a DMP finds that:

- 35% say that other options for dealing with their debts, such as an IVA or bankruptcy, were not discussed before they started their DMP;
- 10% of individuals in a fee-charging DMP say they were not told that they would be charged until after their plan began;
- 22% say the organisation that set up their DMP did not ask for proof of income and expenditure before the plan began; and
- 15% say their DMP provider made late payments to their creditors even though they had made the agreed payments at the right time.

18. A survey of 300 Insolvency Practitioners[98] shows that 57% have seen individuals whose DMP had failed because the amount of debt they were in was simply too high to make a DMP a feasible option in the first place; while 46% have seen DMPs fail because the monthly payments were simply unaffordable; and 40% have seen DMPs fail because the repayment timescale was too unrealistic.

19. The most recent OFT report on compliance with debt management guidance found widespread non-compliance. This suggests that the OFT's regulation and enforcement activity is insufficient to tackle bad practice, mainly because the bulk of investigatory work is reactive rather than proactive.

20. We believe regulation of DMPs should lie with the Insolvency Service (IS), which currently has responsibility for the regulatory framework surrounding formal insolvency. The similarities between DMPs and formal processes such as Individual Voluntary Arrangements ought to result in similar regulatory regimes. A good starting point would be the registration of DMPs to elucidate more information about them. Moving

[97] Debt and Insolvency: the full picture, April 2010.
[98] November 2009.

regulatory responsibility to the IS would also address concerns that too many arms of Government are involved in debt and insolvency regulation.

21. The Government has proposed a DMP protocol, akin to the existing IVA protocol. Although the IVA Protocol has had some success, it leaves much to be desired—mainly because lenders exert disproportionately more influence than debtors or intermediaries. While protocols designed and implemented by Government, creditors, providers and consumer groups have their uses, they are generally incapable of tackling the "bad guys" who can continue to operate comfortably outside their reach. In a recent court case,[99] the Judge reiterated that the IVA Protocol is no more than a voluntary code of practice.

22. A DMP Protocol does not supplement existing legislation in the way that the IVA Protocol does. While there is nothing in the IVA Protocol to "punish" an Insolvency Practitioner if they breach the Protocol, the Insolvency Act 1986 and its associated rules facilitate this. By comparison, the DMP Protocol does not supplement any existing law. There is nothing to fall back on beyond the Consumer Credit Licence rules, which do not tell a provider how to "do" a DMP.

23. A DMP Protocol is an improvement on the status quo, but we would prefer more stringent regulation by the Insolvency Service. DMPs are a significant part of the debt landscape—they should be regulated as such.

Basic bank accounts for bankrupts

24. We support the Government's intention to ensure banks provide basic accounts for undischarged bankrupts. The Government states that "the banks tell us that they would be willing to offer such facilities were it not for the risk of becoming liable to claims by trustees in bankruptcy relating to property acquired by a debtor during the course of the bankruptcy. In recognition of this, the Government will be issuing in due course a consultation to seek views on amendments to insolvency legislation".

25. We do not understand why the banks believe they have grounds to fear becoming liable for after-acquired property in this way. There have never been any cases that would lead the banks to develop this conclusion and a number of banks currently offer basic bank accounts to undischarged bankrupts (Barclays and The Co-operative).

Money Advice Service (MAS)

26. We welcome the Government's commitment to ensuring that the MAS takes *"a direct role in debt advice"* from 2012–13, recognising the value of the not-for-profit sector in debt advice provision.

27. As budget cuts put pressure on the not-for-profit sector, we would like to see the MAS's review into debt advice take into account the contribution of the private sector. The National Audit Office (NAO) report into over-indebtedness in 2010 cited that there are 56,000 companies able to provide debt advice; and while the not-for-profit sector provides a considerable amount of debt advice, their survey of indebted individuals reveals that 28% received advice from a bank, 25% from a fee-charging professional adviser, and 21% from a free debt advice service.

28. We do not suggest that the private sector can replace the not-for-profit sector; simply that the contribution of both ought to be taken into account when assessing the provision of debt advice.

Changes to existing procedures

29. We support the Government's intention to consult on increasing the petition level for creditors[100] and agree that making an individual bankrupt on a £750 debt is disproportionate.

30. The rise of Individual Voluntary Arrangements has rendered Deeds of Arrangement virtually obsolete so we support Government plans to repeal the relevant provisions.

31. As there are only 5,000 County Court Administration Orders each year, the Government is considering abolishing relevant provisions. We do not see any obvious benefit of going to the expense of repealing provisions if 5,000 people find the procedure useful.

Missed Opportunities

Quality advice

32. In relation to the quality of advice, the Government response states that "there was significant support for the concept of the role for a gatekeeper to provide a common entry point to all formal insolvency procedures".

33. In order for the personal insolvency system to operate at its best, financially distressed individuals need to enter the solution best suited to their situation. Widespread support for a gatekeeper stems from concerns about a lack of impartial advice, with suggestions of "poor advice" from both profit and not-for-profit providers and evidence of mis-selling of products by providers offering only a single solution.

[99] Mond & Anor v MBNA [2010] EWHC 1710.
[100] A creditor has adequate grounds for applying for an individual's bankruptcy if they are owed £750.

34. While it is useful to have a number of debt solutions to suit a range of circumstances, R3 believes individuals should be able to take a decision based on impartial and full advice in an environment in which they can weigh up their options. We have previously suggested that indebted individuals should be able to apply for a moratorium (formal breathing space) from creditor action for four weeks, during which time they are required to seek advice from impartial advisors.

35. A "panel" of advisors could be drawn from a range of backgrounds—not-for-profit agencies such as the CAB, IPs who have a statutory duty to provide full and impartial advice, or other "approved intermediaries". The only requirement should be that all advisors are aware of the range of options and that they offer full and impartial advice.

36. We would like the Government to consult on various models proposed to tackle the problem of "bad advice", including R3's suggested moratorium and panel of advisors.

The introduction of "Simplified IVAs"

37. The Government response states that "*respondents felt that lenders exercised too much control in IVAs*". We are therefore disappointed that they do not intend to take action in this area, and surprised by their implicit endorsement of the IVA Protocol as a model for the DMP Protocol.

38. The IVA Protocol was intended to remove obstacles to obtaining IVAs by encouraging lenders not to insist on unhelpful modifications in simple consumer debt cases. But a considerable number of IVAs are still refused by the banks or modified so severely that they become unviable. The danger is that the individuals who have viable IVAs refused enter a solution that is less suitable for their circumstances—eg bankruptcy or a DMP.

39. According to the IVA Protocol Review in December 2009, 97% of IVA proposals were modified before they were accepted by creditors. Meanwhile a survey of over 300 Insolvency Practitioners found that 30% have seen banks or ABLs refusing a reasonable offer of repayment through an IVA because they have initiated enforcement action, and 42% have seen lenders do so because they are the largest creditor. In view of the high rejection rate and modifications, many IPs no longer advise indebted individuals to propose IVAs, wary that they will be refused.

40. There are two key "groups" that access the personal insolvency system: small, consumer debt cases; and more complex cases, including the consequences of business failure. We believe the system should differentiate between these groups and that simpler cases should be eligible for a simpler solution—best achieved by the introduction of the Simplified IVA (SIVA).

41. SIVAs would require approval by simple majority—removing the power of minority creditors to block the arrangement (IVAs require 75% approval)—and would not allow modifications. In 2008, the Government recognised concerns over access to IVAs and planned to introduce SIVAs. Proposals were withdrawn at the last moment because the Protocol was established and thought capable of solving the problems. However, the Protocol has not resolved concerns around access to IVAs. The arguments for introducing SIVAs holds firm—they are just as relevant today as they were before. The Government should revisit their plans to introduce SIVAs to increase access to IVAs.

Cost of bankruptcy

42. Respondents to the Review commented that there are some cases where debtors cannot access a repayment solution because they do not have sufficient surplus income, but cannot afford the £700 needed to apply for bankruptcy.

43. It is counter-intuitive that people who are hugely indebted have to find £700 to apply for bankruptcy, unless they go further into debt and/or avoid paying other creditors. While charities sometimes offer to cover the cost of bankruptcy, this is unlikely to cover all potential bankruptcies.

44. A recent survey reveals that 29% of Insolvency Practitioners have seen debtors unable to afford to go bankrupt during the last twelve months, even though bankruptcy would have been appropriate. Asked what tends to be the next step for the debtor in this position, 58% said "*the individual does not address their debts*". This risks debtors accruing more debt, avoiding paying their creditors and being pursued. There are also concerns that these debtors enter other remedies less suitable for their circumstances—eg a DMP. One of our members is currently advising an individual in the South West: despite selling her property to pay creditors, she still has unsecured debts of over £140,000; she has pressing creditors that she finds harassing and distressing, but simply cannot find the £700 to go bankrupt.

45. Although the cost of bankruptcy was not addressed in the Government's response, a subsequent consultation[101] has been announced on whether this cost could be paid in instalments instead, which we welcome. The Government should also consider raising debt and asset levels in Debt Relief Orders (DROs) to widen access to debt relief.

[101] IS Consultation: Reform of the Process to Apply for Bankruptcy and Compulsory Winding Up—November 2011.

R3 Reccommendations

46. Our recommendations are as follows:

- — A DMP Protocol is an improvement on the status quo, but is incapable of tackling the "bad guys" operating at the margin of the DMP industry. We believe regulation of the DMP industry should lie with the Insolvency Service (IS) which currently has responsibility for those who provide formal insolvency procedures.
- — The MAS review into the provision of debt advice should take into account the contribution of the private sector as well as the not-for-profit sector, as both play a role.
- — Given widespread concerns about the quality of debt advice, we would like the Government to consult on various models proposed by respondents to tackle this problem.
- — SIVAs should be introduced to address current difficulties over access to IVAs and enable those who want to repay to do so.
- — In line with the current consultation on petition reform, individuals who cannot afford to go bankrupt should be able to pay in instalments. The Government should also consider raising debt and asset levels in Debt Relief Orders (DROs) to widen access to debt relief.

14 November 2011

Written evidence submitted by the UK Cards Association

The UK Cards Association's response to the Call for Evidence ("Managing Borrowing & Dealing with Debt")[102] focussed on those areas which were of greatest relevance to the cards industry, primarily around the areas of rate capping and re-pricing. We also supported the submission from the British Bankers' Association (BBA), where there is a significant overlap in membership, in respect of the more general issues across the debt management and personal insolvency landscape.

This BIS Committee inquiry focusses on Debt Management and we again fully support the BBA's response. However, there are two specific points which we would particularly like to make:

Breathing Space

The Association was instrumental in delivering the original commitment in early 2009, working very closely with our colleagues from across the debt advice sector. We very much welcome the Government's approach in building on existing voluntary codes and in particular the decision to engage with non-financial creditors, including local authorities and government departments. We believe it to be important that these discussions are now progressed with some urgency.

Credit Data Sharing

We understand that it is the Government's intention to resurrect the previously formed cross-Whitehall data sharing group. We very much welcome this and look forward to playing a leadership role in developing its priorities. However, we are concerned that it has been some time since this was announced and we would hope that this work will gather pace over the coming weeks.

The UK Cards Association is the leading trade association for the cards industry in the UK. It is the industry body of financial institutions who act as card issuers and/or acquirers in the UK card payments market and is responsible for formulating and implementing policy on non-competitive aspects of card payments. The Association promotes co-operation between industry participants in order to progress non-competitive matters of mutual interest and seeks to inform and engage with stakeholders to advance the industry for the ultimate benefit of its members' consumer and retail customers.

14 November 2011

Written evidence submitted by the University of Bristol Personal Finance Research Centre (PFRC)

Summary

- — Research evidence suggests that concerns about the quality of fee-charging debt advice services contrast sharply with the high quality found among the free-to-client services.
- — However, public awareness of free-to-user money and debt advice services remains a significant problem, and would benefit from an approach modelled on the fee-charging debt advice sector in which TV and newspaper advertising and the internet have prominence.
- — Severe financial strain, which is not necessarily evidenced in arrears, is currently an acute problem among households in Britain.

[102] HM Treasury/Department for Business, Innovation and Skills, Managing Borrowing and Dealing with Debt, Call for evidence in support of the Consumer Credit and Personal Insolvency Review, 2010

- — People struggle to recognise the financial strain they are under and the risks presented by their difficulties and have little understanding of how advice services can assist them at different stages of the financial difficulties process.
- — Research shows that customers are generally receptive to proactive offers of assistance from creditors.
- — A joined up approach to money and debt advice services between creditors and free-to-user debt advice services is needed.
- — Some people are deterred from seeking debt advice due to concerns about the impact of debt solutions on their credit ratings.

1. This submission is based entirely on empirical research evidence and is not based on opinion.

2. Our submission in response to the *Managing Borrowing and Dealing with Debt: Consumer Credit and Personal Insolvency Review* Call for Evidence highlighted relevant findings from a PFRC study of the fee-charging debt management industry (S. Collard, An independent review of the fee-charging debt management industry, Money Advice Trust, 2009). The review noted the difficulties individuals can have negotiating with creditors without the input from a professional third party. However, it also highlighted concerns about the quality and high cost of services provided by the fee-charging debt advice companies. It found that some clients cancelled their debt management plans and were in a worse financial situation now than when they first contacted the company. In contrast, earlier research found almost universally high quality of advice among the free-to-user debt advice sector (S Collard, J Steele & E Kempson (2000) *Quality assured: the quality of money advice services in the UK*, Money Advice Trust and S Collard & B Burrows. (2002) *Good, bad or indifferent? The quality of money advice in Scotland,* Money Advice Scotland).

3. The research further underlines the importance of promoting public awareness of free-to-client money advice services. It highlighted the prominence of TV and newspaper advertising and the internet for finding out about commercial debt advice companies (Collard, 2009). In contrast, clients of free-to-user services most often found out through a referral from a friend or family member, creditors or other professionals (L Day, S Collard & C Hay (2008) *Money advice outreach evaluation: qualitative outcomes for clients,* Legal Services Research Centre). This suggests that with support from Government and the Money Advice Service, there is scope for promoting better public awareness of money and debt advice services through advertising.

4. More recent research that PFRC has undertaken and which was not included in our earlier submission has evidenced the strain that households in the UK have been under in recent months. This includes not only those households who have fallen behind with their commitments, but also those who have struggled but nonetheless managed to keep up with their commitments. (A Finney, 2010, *The Genworth Index volume 4: Measuring consumer financial vulnerability and security in 18 markets*. Genworth Financial; A Finney and S Davies (2011) *Facing the Squeeze 2011: A qualitative study of household finances and access to credit*. Money Advice Trust; and S Collard (2011) *Understanding financial difficulty: Exploring the opportunities for early intervention*. Barclays.)

5. First, a survey of consumer financial vulnerability undertaken in 2010 found that 43% of British households had experienced financial difficulties with their household bills or credit commitments at least sometimes in the past 12 months. This figure had increased from 31 per cent in 2007 (Finney, 2010).

6. Second, PFRC research for the Money Advice Trust highlighted the lengths that some households have gone to in order to cope with difficult and changing financial situations. The more extreme approaches included selling cars, pets and other personal goods, relying on friends and family to get by, and borrowing to repay other borrowing. Others included checking bank account balances daily, prioritising bill payments over all other things and fully drawing down savings. These strategies were often used to avoid falling into arrears, although they were not always sufficient to prevent people doing so (Finney and Davies, 2011).

7. The same study suggests that people have difficulty reading the signs that indicate the severity of the financial strain they are under. They also have little awareness of the advice services that might be available to them, or understanding of how these services might help them, at different stages of their deterioration into financial difficulties (Finney and Davies, 2011). Our research for Barclays found that customers are generally receptive to proactive contact from their bank to help resolve financial issues they have before they fall into arrears (Collard, 2011). Together, the findings highlight the need for a joined up approach between financial services providers and money and debt advice services to ensure that financial strain is detected and tackled at an early stage.

8. We note the proposal to improve credit reference agencies' understanding of different types of insolvency procedure so that they can be better reflected in a debtor's credit rating. Based on evidence from our research we would strongly support this as a positive step towards improving debt advice take up. Our research indicated that concern about the impact of debt advice on credit ratings deterred households that were overstretched or in financial difficulty from seeking or taking advice (Finney and Davies, 2011).

17 November 2011

Written evidence submitted by Veritec Solutions

EXECUTIVE SUMMARY

- The development of the UK's high cost credit sector has followed the same trajectory as in the US with a number of US payday lenders now operating in the UK.
- There are four main factors that cause consumer detriment in the high cost credit sector. These are:
  - Affordability.
  - Multiple loans.
  - Rolling over loans.
  - Cycle of debt.
- High APRs may grab headlines but they are not in themselves a main factor in consumer harm.
- All the evidence from US states that introduced APR rate caps suggests that caps are ineffective and have "unintended consequences" of reducing consumer choice, pushing people towards loan sharks and other unlicensed operators.
- There are more effective ways of regulating the high cost credit sector that protect consumers but allow for a viable short-term lending industry. These typically include setting maximum loan amounts, banning rolling over, limiting penalty fees, and imposing cooling-off periods in between loans.
- In states that have adopted these measures, loan transaction volumes have initially declined, but lenders adapt to the changes, and actually improve their loan losses and there still remains a demand for their product.
- The key factor in creating an effective system is the means of enforcing the chosen rules. Technology is an essential tool that has been successfully deployed by many states to eradicate non-compliant lending behaviour.
- Veritec believes that the committee should look closely at the Government's plans for effectively enforcing its favoured policy option because if the regulators are unable to enforce the policy, there is no use in moving beyond the status quo.

1. *About Veritec*

1.1 Veritec is contributing to this call for evidence as an impartial witness with over a decade's experience of consumer credit regulation in the United States. Our submission will concentrate on the views on high cost credit outlined by the Government in its summary of responses on consumer credit.

1.2 Veritec provides a data system that enables regulators to effectively enforce regulation of payday, doorstep and other short term consumer lending. The company has over 10 years' experience of working with US regulators in thirteen different states, covering 88 million consumers. In addition to its work in the United States, we have also advised the Provincial Governments of Ontario and British Columbia in Canada, and the Federal Government of Australia.

1.3 Veritec's data system contains over 100 million records for small dollar consumer finance transactions (payday loans, instalment loans, log book loans, high cost mortgage loans) and 7,200 store locations.

2. *Applicability of international experience to the UK*

2.1 The development of a high cost credit sector, and the associated concerns for consumer protection, is far from unique to the UK although there are distinctive features. In many ways the debate in the US on how to regulate short term credit is more advanced than in the UK. Concerns about short term credit first surfaced in the US over 10 years ago and both the New York Federal Reserve and the Federal Deposit Insurance Corporation have studied the market in recent years.

2.2 In the US, responsibility for regulating short-term high cost consumer credit providers lies with the individual states. So far 13 states, with a total of 88 million consumers, have introduced some form of controls which allow a profitable short term product, but at the same time either ban loan roll overs or cap the number of loans able to be taken out at one time, as long as the total borrowed does not exceed some means type testing. The variety of policy responses put in place by different states provides a broad view of the pros and cons of different regulatory approaches.

2.3 There are more similarities between the US and the UK. Many US companies have decided that the UK market offers greater potential for growth. Five of the seven largest payday lenders in the UK are owned or controlled by US companies.

3. *Diagnosing the problems in the high cost credit sector*

3.1 Our own experience and all the available research tells us that there are several common factors that cause issues for users of short-term loans in the US, Canada and the UK.

3.2 These are:

- *Affordability*—consumers end up borrowing more than they can reasonably pay off on payday.
- *Multiple loans*—consumers borrow from several lenders at the same time.
- *Rolling over*—consumers extend their loans indefinitely while incurring new fees every two to four weeks.
- *Cycle of debt*—consumers unable to pay off the extended loan that has now been increased by outstanding fees, transforming a short-term, high cost product into a long-term, extremely high cost loan.

3.3 In order to be successful, the Government's policy response to concerns in the sector has to address all the factors outlined above.

APR Caps

3.4 Much has been made recently about high APRs attached to short-term credit, particularly payday loans—a product that has been thrust into the headlines because loans often have APRs in excess of 2,000%. In July 2011 the Government announced that it would be conducting research into the effects of a variable rate cap because of these concerns.

3.5 Evidence strongly suggests that a rate cap is a counter-productive response. In Pennsylvania the regulatory authorities imposed a rate cap of 24% but this reduced profitability so much that licensed lenders have withdrawn from the market, effectively regulating the product out of existence in the State. A credit union model backed by a State-sponsored reserve attempted to fill the gap left by payday lenders but has not been particularly successful, with annual loan volume down from four to five million prior to the ban to well under 100 thousand loans. The ban has drastically cut supply without reducing demand; instead it has limited choices for consumers pushing them instead towards illegal and unregulated lending and the State's Attorney General's office has spent hundreds of thousands of dollars trying to shut down illegal, offshore internet lending.

3.6 On the other end of the scale, higher rate caps that allow for profitability do nothing to protect consumers. It is actually more likely to increase costs for consumers across the board as companies no longer have to compete on price.

4. *International policy solutions*

4.1 It is possible to design a regulatory system that protects consumers while allowing payday and other short-term high-cost lenders to operate profitably. After a decade of varying regulatory responses, policy responses in the US and Canada are now more consistently based on the following measures:

- Setting maximum borrowing limits at reasonable cap or percentage of monthly gross income.
- Ensuring maximum amount borrowed does not exceed limits among all licensed lenders and products.
- Severely restricting or prohibiting extending a loan for additional fees, mandating the implementation of repayment plans, and enforcing a "no borrowing during repayment plan" rule.
- Establishing reasonable fee structures that allow for lending profitability while enforcing consumer protections.
- Enforcing mandatory cooling-off periods in between loans or after a specified number of days "within the product".

4.2 By correctly diagnosing the causes of consumer detriment, regulators have focused their interventions on measures that ensure short-term lending does not morph into longer-term credit with exceptionally high fees.

4.3 Lenders argue that greater regulation will limit the amount of loans granted and reduce choice for consumers. While it is true that loan volume has dropped in the immediate aftermath of states implementing these forms of regulation, business activity has recovered and the quality of loans has improved, actually benefiting lenders in the mid to long term. For instance, following the introduction of regulatory frameworks such as this, loans increased over the same month the previous year by an average of 5%. The State of Florida's payday loan volume has grown from under three million loans during 2002, to almost seven million by the end of 2011.

5. *Enforcement: the critical factor*

5.1 We are concerned that the current public debates on consumer credit regulation either completely ignore the issue of enforcement or touch upon it superficially. But this is a critical factor in the success of any regulatory regime. Our extensive experience of working with regulators and lenders in the US, and our analysis of the UK regulatory regime, has taught us that regulations are only as good as the system put in place to enforce it.

5.2 Lenders operate in different ways. Some have a "bricks and mortar" presence, others visit borrowers' homes and some are based online, a growing part of the sector, especially in the UK where internet lending far outstrips the same sector in the US. There is a great incentive for lenders to invest in their technological infrastructure in order to provide consumers with loans in a matter of seconds and we believe that lenders' technological capability far outstrips that of the regulator; the speed and ease with which consumers can take out loans means consumer harm may occur before regulators, using a retrospective approach, can react.

5.3 Regulatory and enforcement systems must take this new world into account. The success that regulators in the US have had in dealing with consumer detriment has been based on technological solutions that give them real time intelligence that focuses interventions as well as delivering an accurate and up-to-date view on market data and lender/borrower behaviour.

5.4 Technology can also help solve the tricky issue of individuals borrowing beyond their means. Finding a balance between access to credit for financially excluded consumers and restricting inappropriate borrowing is a complex problem for policy-makers and while consumer education is important to solving this, it currently only goes so far. Experience from the US shows that using a system that gives individualised consumer-focused information at the point of sale—so that consumers know when and why they have reached their borrowing limit—can be much more effective.

6. *Case study: Florida*

6.1 Florida has nearly 19 million residents. These residents take out a cumulative total of 570,834 loans per month from 1,500 licensed stores operated by 192 companies.

6.2 In 2001, Florida implemented new regulations on payday lending that stipulated a maximum sum of $500, limited transaction fees to $10, banned rolling over, restricted loan terms to a maximum of 31 days, and imposed a cooling-off period of 24 hours between loans.

6.3 The effects have been dramatic. Florida authorised 6.8 million loans in 2009–10 in which not a single loan was extended beyond the contract for additional fees. Over 90% of borrowers repaid those loans within 30 days of the due dates. Over 70% of borrowers repaid their loans on their contract end date. The level of consumer complaints of mis-selling and over-indebtedness has dropped dramatically and complaints about high interest rates have all but disappeared. In fact, not one loan issued in 2011 violated any portion of the Florida statutes governing short term credit. Not one borrower was indebted more than $500 at any given time in the State. Additionally, the average Florida consumer borrows only $390 when they do borrow. The program has been so successfully, in over 10 years, the Florida legislature has not sought to change ANY of the current Florida short term loan statutes.

6.4 Loan volume did drop immediately after the database was introduced. The drop in volume is due to the effectiveness of the database in preventing non-compliant loans (eg borrowers who take loans from one lender to pay off another lender get "shut out" when the database is implemented).

6.5 The estimated drop in transaction volume when the database was implemented was between 20% and 30% of previous transaction activity. The transaction volume recovered to pre-database levels after approximately 12 months. Since implementation, the average year on year loan transaction volume increase in Florida has been over 18%, clearly demonstrating that a sustainable, responsible lending model is viable.

7. *Recommendations for the committee to consider*

7.1 We strongly believe that the Committee's inquiry should focus on issues beyond high APRs to address the real causes behind consumer detriment in the high cost credit sector.

7.2 In addition to examining policy options open to the Government, the committee should look closely at the Government's plans for effectively enforcing whichever policy it pursues because if the regulators are unable to enforce the policy, there is no use in moving beyond the status quo.

14 November 2011

Written evidence submitted by Which?

SUMMARY

1. Which? welcomes the opportunity to submit evidence to the BIS committee inquiry. In this document, we mainly address three issues. These are: unauthorised overdraft charges, debt management company practices and payday loans.

2. We believe that there are substantial sources of consumer harm present in these markets. We have argued that:

- the high level of charges levied on unauthorised overdrafts are unfair and disproportionate;
- the move to daily charging structures reduces the level of control for vulnerable consumers to stop charges escalating;

— existing loopholes in the regulation around Unfair Terms in Consumer Contracts need to be closed—we have proposed a solution for this;

— the powers of the Financial Conduct Authority to tackle excessive charges need to be clarified;

— there need to be clearer rules on the operations of debt management companies tackling very high fees, the practice of front-loading fees, commission-led sales and cashback offers;

— payday loan companies must stop the harmful practices of rolling over loans and aggressively marketing further loans; and

— consumer protection needs to be strengthened and a greater obligation be placed on debt management companies and high cost credit providers to direct borrowers to unbiased and affordable sources of debt advice.

Provision of Credit Facilities: Unauthorised Overdraft Charges

3. Which? believes that the Government needs to take greater legislative action to address consumer concerns over the high cost of unauthorised overdraft charges (UOCs). Banks and building societies see UOCs as an important stream of income and will continue to do so, especially in times of low interest rates. There is therefore little incentive for banks to address the situation and reduce the cost of unauthorised overdrafts to consumers.

4. As a result of the very high fees that are being charged to consumers, we urge the Government to consider unauthorised overdraft charges as part of the high cost credit market and include them in their forthcoming inquiry into this sector.

5. The financial interest banks have in high UOCs means that market driven initiatives cannot work. Whilst banks have, in response to the consultation, argued that competitive pressures would result in better outcomes, we believe that little substantial improvements have taken place in recent months and years.

6. Competitive pressures cannot and will not work because UOCs are not the basis on which banks compete. Consumers seeking to open a bank account primarily consider factors such as monthly fees, the interest rate earned on accounts in credit and additional services such as insurance. This is also reflected in the way current accounts are marketed and advertised by banks—little emphasis is given to UOCs. As a result, UOCs are likely to be of secondary importance to consumers, especially if they aren't immediately aware of the high cost involved.

7. We agree that some progress has been made in terms of making UOCs more transparent and consumers are becoming increasingly aware of the high cost of using unauthorised overdraft facilities. However, Which? strongly believes that UOCs are too high and unnecessarily penalise consumers that are already vulnerable.

8. In addition, consumers that find themselves trapped in a spiral of UOCs are unlikely to be able to switch current accounts unless they can secure a significant overdraft facility on the new account. We believe that this is a serious impediment to consumer choice and blocks off one of the ways in which consumers could work off their debt by seeking out a current account with more favourable conditions on UOCs.

9. Which? wants charges to be proportionate to the cost incurred by banks in providing this facility. Despite having asked banks to justify their charges, we have not received an explanation of the relation between charges and costs to banks.

10. Charges should also be clearly laid out and structured in a simple way. We have noticed that in some cases banks have charging structures that are layered and complex thus adding costs on top of the charges for using an unauthorised overdraft (eg paid item fees, unpaid item fees, interest rates added on top of overdraft usage fee). This makes it hard for consumers to work out how much exactly they will be paying for using an unauthorised overdraft or to compare how much they would pay at another bank.

11. Some banks do not charge if consumers go overdrawn by a small amount and others have reduced their charges for unpaid items. Despite these small improvements, there has been a proliferation in daily charges, which is of particular concern to vulnerable consumers on low incomes, who might not be able to pay money into the account to get out of the overdraft. Whilst maximum levels are applied in most cases, these maxima are often too high and could affect consumers' ability to get out of the overdraft fast.

12. We believe that the charges on using overdraft facilities are often disproportionate. Halifax currently charge up to £155 per month for some of their accounts, the RBS and Natwest charge up to £186 on most of their accounts while Barclays customers could find themselves owing up to £132 to their bank in some months.[103]

13. Often, the maximum charge per month only applies to the daily charges. This means that consumers could still be paying more than the maximum if they continue to make payments from their current account, as unpaid and paid item fees are likely to be charged. Santander, for instance, charges £25 for paid and unpaid

[103] The £155 maximum charge applies to Halifax's Ultimate Reward, Reward and standard current accounts. The £186 charged at RBS and Natwest apply to Select Silver, Select, R21, Advantage Gold, Royalties Gold, Royalties Premier and Black accounts. Barclays charges a £22 daily fee for each period of five consecutive days which could result in a maximum of £132 in calendar months with 31 days.

items regardless of the value of the payment on some of its current accounts. Clydesdale Bank and Yorkshire Bank charge the same amount for paid items and as much as £35 for bounced payments.

14. Despite the multitude of charges that are already being levied on consumers that use unauthorised overdrafts, some banks continue to also charge high interest rates on the value by which consumers go overdrawn. Lloyds TSB charges between 12.43% and 19.28% EAR, Nationwide charge 18.90 EAR and Yorkshire Bank and Clydesdale Bank both charge 29.99% EAR.

15. Only one bank and one building society offer the ability for consumers to opt-in/opt-out of having an unauthorised overdraft on all of their accounts.[104] We believe that it would be advantageous to consumers if more banks offered this facility on their accounts. In the US, rules were introduced during 2010 by the Federal Reserve which only allow banks to process ATM and debit card transactions which would take the consumer into an overdraft (or over their overdraft limit) if consumers have specifically opted-in.[105]

Changes to the Unfair Terms in Consumer Contracts Regulation (UTCCRs)

16. The Supreme Court decision in the bank charges case exposed an unexpected legal loophole under the UTCCRs and significantly clipped the wings of the OFT and other regulators. Contrary to the generally held view that only the "main price" payable under a contract was protected from a fairness assessment, the Supreme Court's decision indicates all and any prices are now protected. This is contrary to the underlying policy of the UTCCRs which was to protect consumers from unfair terms hidden in contractual small print.

17. Which? believes the UTCCRs should be amended to ensure the previous position is restored—a move that would not impose a significant regulatory burden as it represents the basis on which most, if not all, companies have been operating. Neither would it represent a form of price control—it simply allows terms to be assessed for fairness and thus provides an incentive for businesses to adopt their own fair pricing structures.

18. The implications of the Supreme Court's decision reach far beyond UOCs. Which? believes that the UTTCRs should be amended to ensure the loophole is closed in respect of all consumer contracts. However, we recognise the issue has arisen most significantly in relation to bank charges and that it may be desirable to address that first. If a narrower solution is favoured by Government then it should be introduced on the understanding this is the first step of a multi-stage process. We therefore suggest two potential options (set out in Annex 1) for change:

- one simple amendment to limit the changes to financial services contracts and to ensure minimal disruption to the current operation of the UTCCRs; and
- a second which represents a more prudent policy position on which to legislate in respect of all consumer contracts.

The Role of the FCA

19. The Independent Commission on Banking (ICB) recommended that the FCA should take a stronger role in promoting competition. The ICB noted that the FCA "would have the ability to tackle unarranged overdraft charges, where it was ultimately judged that the OFT's power under the relevant part of general consumer law did not give it scope to make a substantive assessment of the issue."[106]

20. We agree that it is essential for the FCA to be able to limit ancillary/default charges if it is to take an effective approach to competition. These "behind-the-scenes" prices can lead to a substantial risk of weakening of effective competition between firms, in particular reducing direct price competition as apparently low "headline" prices mask the true costs once ancillary/default charges are accounted for. Discovering the "true" price raises consumers' search costs, especially if price structures are frequently altered. This will distort consumer decisions leading to inefficient economic outcomes. A regulator with a clear competition mandate would ensure that consumers can be confident that once they have entered into a contract, they will not be subjected to any unexpected charges or, if they are, such charges are fair and proportionate.

21. The section on pricing in the FCA Approach Document sets out the regulator's view:

> "The government has said that the FCA will not be an economic regulator in the sense of prescribing returns for financial products or services. The FCA will, however, be interested in prices because prices and margins can be key indicators of whether a market is competitive. Where its powers allow, the FCA will take into consideration more positively the cost of products or services in making judgements about whether consumers are being fairly treated.
>
> "Where competition is impaired, price intervention by the FCA may be one of a number of tools necessary to protect consumers. This would involve the FCA making judgements about the value for money of products.
>
> "The FCA will thus consider exercising its powers to take action where costs or charges are excessive."

[104] Barclays bank and Nationwide Building Society.
[105] Federal Reserve, Federal Register Notice, Regulation E, Electronic Fund Transfer Act http://edocket.access.gpo.gov/2009/pdf/E9–27474.pdf
[106] Independent Commission on Banking, Final report, para 8.82.

22. However as our barrister, John Odgers, notes:

> "It is not clear whether, by not including in the Bill any specific provisions relating to price intervention, the Government intends the regulators to enjoy no such powers or whether it considers that price intervention is permissible under these rule-making powers.
>
> "It seems to me to be desirable that a power of price intervention should be spelled out, if it is intended. Financial services regulators have not in this jurisdiction previously exercised that type of power, and might in future be loath to do so without a specific statutory authority, as the use of such a power would be particularly likely to attract a challenge."

We would therefore welcome clarification from the Government on this matter. If the legislation is not clarified then we see significant risks of another legal issue similar to the bank charges case, where it is necessary to go through a long and expensive legal process to define the regulator's powers.

Debt Management Companies

23. Which? believes it is important that independent, affordable and regulated support mechanisms are available to those that are in debt and that struggle financially. We are however concerned that some consumers may be lured into using debt management companies (DMCs) by the promise of having their debt written off in a fast and easy way.

24. Many DMCs have sprung up in recent years but their rise has been accompanied by mis-selling, cold-calling, mis-leading advertisements and inflated claims. Worst of all, many of these companies charge high fees for their service, which could aggravate the woes of those that are in debt. By paying a substantial sum of money to DMCs, less can be contributed to paying off debt, which could potentially lengthen the repayment period. It could also result in individual voluntary agreements (IVA) being rejected by creditors as creditors usually insist on a minimum "hurdle rate" of repayment.

25. We believe that this is a serious problem as the "next best" solution offered by commercial debt management companies would usually be a debt management plan (DMP), which could last decades. Unlike IVAs, which usually involve a partial debt write-off, the DMP option only reschedules the debt repayment, therefore potentially resulting in much higher interest payments over the term of the rescheduled loan.

26. Further research conducted by Which? Money at the end of last year revealed that many DMCs charged fees of potentially more than half of customers' debt repayment in the first year. Monthly debt repayment charges usually represented about 17% of the repayment value. Some companies charge a minimum monthly amount for their services, which could be particularly detrimental to those who can afford to repay relatively small amounts of money.

27. Front-loading of fees is another issue that Which? believes needs to be tackled effectively. Some DMCs use the first few months' repayment to recoup some or all of the fees they are owed. This means that borrowers could be spending at least some of their repayments on paying fees before they even get to repaying any of their debts. This could push consumers' further into arrears, causing damage to the individual's credit file and increasing the debt owed to creditors.

28. Which? is concerned that the practice of front-loading could also encourage mis-selling. Because fees are front-loaded and DMCs recoup a large chunk of their money in the first few months of the repayment plan, they still make a substantial profit from borrowers even if the plan fails. There is a clear risk in this structure that DMCs will set the monthly repayments at a higher level than the borrower can afford. They thereby maximise their own gains and increase the risk of the repayment plan failing. If the plan fails, DMCs can move borrowers into an IVA and charge them for switching.

29. Which? is also concerned about the potential proliferation of commission-led sales. We have seen evidence of DMCs offering high commission payments to financial advisers for receiving referrals. We believe that this practice needs to be stopped as it encourages financial advisers to refer borrowers to potentially expensive debt solutions rather than pointing them towards free or affordable sources of help.

30. We have also seen examples of debt management companies offering cashback to borrowers via the website Quidco. These cashback deals could potentially encourage consumers to take out debt management solutions that are not in their best interest and that cost a lot of money. We found that one offer for £25 cashback on Quidco's website did not give any details about the DMC offering the deal. The company, Money Advice Group, would in fact keep the first month's repayment and all but £1 in the second month. It would then charge a monthly fee of at least £37.50 for the rest of the repayment period. We believe that this and similar deals offers very poor value and could lure in debtors that are desperate to get hold of some cash.

Payday Loans

31. Whilst payday loans remain a niche credit market, the value of payday loans taken out by borrowers has increased from £1.2 billion in 2009 to £1.9 billion in 2010, suggesting that more consumers are turning to this form of credit. As lending criteria have been tightened and the rising cost of living is putting more and more households under financial pressure, it is important that the Government and regulators take steps to strengthen consumer protection in this sector.

32. When we investigated eight online payday loan companies a few months ago, we found significant problems with the lenders in terms of the marketing materials they sent out, inappropriate and unsolicited increased loan offers and unrequested roll-overs.

33. One of the main problems was not only the sheer volume of marketing that was sent to borrowers but also the nature of the marketing. Our researcher received 47 emails from third parties in just a few days after having applied for a loan. They also received numerous text messages and phone calls. All of these communications promoted further payday loans, impaired credit loans and claims management services. None of the communications aimed at helping the consumer resolve their debt problems by informing them about available debt advice or other debt solutions.

34. Some payday loan companies also made unfair comparisons to unsecured bank loans on their websites, comparing the actual interest paid (in £) for their 30-day loans with the interest paid over the term of an unsecured loan, despite the fact that the latter are for a term of three to five years. We believe that this type of comparison is grossly misleading and might not be properly understood by borrowers who believe they are getting a better deal by taking out a payday loan.

35. Furthermore, we found that some companies charge the same amount of interest regardless of whether the customer is borrowing it for 14 days or 31 days. In the case of Payday UK, £25 worth of interest was charged for £100 borrowed regardless of the term—over 14 days this represented an APR of 16,203%.

36. A further problem that needs to be addressed is the endemic practice of rolling over loans at the end of the borrowing term. Payday loan companies often argue that their high APRs are justified because the loans are only meant to be taken out for the short-term. However, our research uncovered that some payday loan companies actively encourage borrowers to extend the loan they've taken out. The company Paydayloan states "loan extension guaranteed" on its website while Payday UK repeatedly contacted our researcher to offer extensions on their loan.

37. Which? is also concerned about the level of the subsequent loans that are available to borrowers, which might encourage some people to take out more than they can afford to repay. One company offered a £1,200 loan to our researcher when they revisited the website, although they initially only took out £100. Payday UK stated that if our researcher paid back the loan, they'd be eligible for £250 on the second, £440 on the third and £630 on the third loan. Quickquid has continued to send out researcher email advertisements offering up to £1,500, even though he had initially applied for just one £100 loan several months ago.

38. We believe that this practice is irresponsible and is encouraging further debt rather than helping people resolve their problems. Payday loans should be considered as a last resort for those that need to repay a bill but cannot access credit. They should under no circumstance result in more debt and protracted interest payments. Guaranteed increases in the amount borrowed and aggressive marketing of roll-overs however achieve the contrary. They make a product that should only be used for short-term borrowing resemble much closer traditional unsecured loans but at a much higher APR than normal.

Annex 1

PROPOSED AMENDMENTS TO THE UTCCRS

1. We believe the following simple amendment to the Unfair Terms in Consumer Contract Regulations 1999 would close the loophole with respect to financial services (as was suggested in the Private Members Bill proposed by Lorely Burt MP):[107]

(1) *After regulation 6(1), insert—*

(2) *"(1A) Paragraph 2 shall not apply to a contract for the supply of personal financial services, including all such contracts currently in force."*

(3) *After regulation 6(2), insert—*

  (a) *"(3) In so far as it is in plain intelligible language, the assessment of fairness of a term in a contract for the supply of personal financial services shall not relate—*

  (b) *to the definition of the main subject matter of the contract, or*

  (c) *to the adequacy of the main price or remuneration, as against the goods or services supplied in exchange.*

(4) *When assessing whether a charge is or is not a main price or remuneration within the meaning of paragraph 3(b), account shall be taken of all the relevant circumstances at the time the contract was concluded, including whether the imposition of the charge is contingent on other uncertain events and whether the charge is likely to have been considered by the consumer prior to concluding the contract.*

(5) *Where a term of a contract for the supply of personal financial services provides for the charging of a consumer and the circumstances in which that charge can be imposed are not certain to arise during the term of the contract, then such price or remuneration shall not fall within the main price or remuneration for the purposes of this regulation.*

[107] See http://services.parliament.uk/bills/2010–11/financialservicesunfairtermsinconsumercontracts.html

> (6) *In any proceedings in which reliance is placed on this regulation, a charge shall be assumed not to be the main price or remuneration, as against the goods or services supplied in exchange, unless the contrary is proved."*

2. Given the breadth of consumer contracts to which the UTCCRs apply, Which? believes a slightly different approach is appropriate for a wider solution and suggests a price should only be exempt from a fairness assessment if:

- — the circumstances in which that price may be levied will definitely arise during the course of the contract; *or*
- — it is the only price that could be payable by the consumer under the contract.

providing that price is one

- — on which the business typically competes ie the headline/advertised/shop window price (as judged on the basis of the business' marketing strategy and commercial practices); *or*
- — that is otherwise prominently provided in good time to consumers prior to conclusion of the contract.

15 November 2011

Written evidence submitted by Wonga.com

1. Background

1.1. Wonga.com, a UK registered company, does not specialise in or claim to offer advice on debt management issues specifically, but we are active in the wider consumer credit market and in particular in the short-term credit sector.

1.2. Wonga.com was invited by the Select Committee on Business Innovation & Skills ('the Committee') to give oral evidence on 29 November 2011 as part of the Committee's present inquiry into debt management. We were however unable to attend on the date requested by the Committee and although willing to give oral evidence (as confirmed to the Committee in writing), no other date has been offered.

1.3. In view of this—and since our name has been mentioned in the context of the inquiry by a witnesses and in questions—we felt that it would be helpful to submit some observations of our own in writing, in addition to the written evidence already submitted by our trade body, the Finance and Leasing Association (FLA).

1.4. In the following section we set out some relevant information about Wonga and our business. In section 3 we address some specific areas which we feel may be of particular relevance to the Committee's inquiry.

2. Wonga and its Business

2.1 Wonga.com, which is a UK registered company headquartered in London, is estimated to be the largest short-term lender in the UK by volume. Since 2008, when the company first became operational, Wonga has undertaken more than 2.5 million short-term loans. Wonga is not a traditional payday lender; the customer has total flexibility as to how much it can borrow and for what period. In addition, we do not have any shops or undertake any sales on a door-to-door basis. The service we provide to our customers is only available online or through a mobile telephone application.

Loan amounts, timescales and pricing

2.2 The maximum loan we advance is £400 for first-time customers and £1,000 for existing customers. The maximum period we lend for is normally 1 month.

2.3 In practice, the amounts borrowed by our customers tend to be smaller than the maximum allowed and for shorter periods. We aim to provide full flexibility to our customers, in that they can choose exactly how much they wish to borrow and for how long, within the above parameters.

2.4 The average loan for first time customers is £160 and the average period is 18 days. From our inception, we recognised the importance of ensuring that customers did not fall into a "debt-trap" in connection with our service. Unlike some other lenders, therefore, we offer all our borrowers the option of repaying early at no penalty—and around 30% do so.

2.5 Our pricing is also totally flexible in relation to the borrower choosing exactly how much they wish to borrow and for how long. We charge interest at the rate of just under 1% per day. The cost of a Wonga loan is accordingly around £1 per day per £100 borrowed, together with a fixed one-off transmission fee for each application of £5.50. The transmission fee covers the faster payment process, as we deliver the money into a customer's bank account within 15 minutes of the loan being approved.

2.6 We aim for our pricing to be totally transparent: i.e. before a customer submits any loan application, we clearly show the daily interest rate and the fee as well as the total cost of the loan. New customers are limited to £400, while returning customers who have shown completely responsible use of the service over a significant period of time and built up a trust rating can borrow up to £1,000.

Customer base and pre-loan checks

2.7 We regularly survey our customers using Populus. Our customer research shows that our customers are typically those earning at least £20,000 per annum. Every Wonga customer has to have a bank account and a fully functioning debit card. All our consumers therefore have access to traditional banking services.

2.8 Our customer surveys show that ours is a mainstream product, with less than a quarter of respondents having previously used another online short term lender. When asked in our customer surveys to rank their choice of borrowing options, after Wonga, respondents indicated bank overdraft, bank loan and credit card in that order. Our most recent customer survey of around 20,000 respondents showed overall satisfaction scores of close to 90%—considerably higher than for any bank.

2.9 We have developed our own risk assessment and credit checking procedures, having recognised that the traditional bank scoring tests were not reliable indicators of a person's ability to repay a loan on time. We use our own algorithm which is continually improving given the number of loans we have made.

2.10 As part of this, we subscribe not only to the major credit reference agencies (who charge us accordingly), but also purchase publicly available data from a wide variety of sources. Overall, we turn down some 60% or more of applications. We do not sell information of these declined applications to any other lenders. We do, however, return data to the credit reference agencies, with the consequence that paying off a Wonga loan on time and in full will improve a customer's credit rating.

2.11 Overall, we aim to lend to those who can afford to repay their loans, not to those who can't. The proof that we are not targeting those unable to pay lies not only in our particularly rigorous checks prior to any loan application being approved, but in the fact that our arrears rate is well below the industry average.

Repeat customers, extensions and arrears

2.12 As in 2.4 above, in recognition of the potential risk for customers of a short-term loan product becoming a long-term loan, we do not encourage or promote loan extensions or 'roll- overs'. If the customer contacts us and requests an extension, they have to pay all fees and interest up to that date and they can choose for how long they wish to extend the loan, for any period up to a maximum of one month. We limit such extensions to three times. In practice, less than 9% of our customers extend once, with less than 1% extending three times.

2.13 Evidently, all the successful applicants to use our service were new applicants when we first established the service. Our average customer now borrows three times a year. However, the same extensive credit checking is undertaken for all returning customers as for new customers—and a large proportion of successful loan applicants remain first-time users. As mentioned, less than a quarter of respondents to our extensive customer surveys have previously used another online short term lender.

2.14 We have a large and dedicated customer support team and we collect our debts in house. We aim to lend to those who can afford to pay us, rather than those who can't—and we have industry-leading low arrears rates as a result. However, if customers contact us with payment difficulties, we work with them to agree a sensible repayment plan. Even if a customer fails to contact us or respond to our attempts to contact them, we freeze interest after 60 days, so that interest cannot mount up indefinitely. We do not use the courts or bailiffs. We subscribe to the Consumer Credit Counselling Service (CCCS) and to and we are in regular dialogue with PayPlan, Citizens Advice, at both the national and local level, and Money Advice Trust.

Code of conduct and sector governance

2.15 Wonga is a member of the Finance and Leasing Association (FLA). The FLA has had a Code of Conduct in place for 19 years. Should any customer make a complaint about our service, we will endeavour to resolve it within 48 hours, but if the complainant is not satisfied they can contact the FLA and request a conciliation procedure. We support the written evidence which the FLA have given to the Select Committee.

2.16 Wonga also produces its own Code of Conduct. This makes it clear that applying for any form of credit is not a decision to be taken lightly. We believe short-term loans should be used for short-term purposes only, not for those with long-term financial problems. A copy of our Code of Conduct is attached in the Annex.[108]

2.17 The high cost credit sector covers a wide variety of lenders, from small local shops to pawnbrokers to home credit and large payday loan companies. The high charges levied by the mainstream banks for unauthorised overdrafts—even for small amounts—also brings them into this sector, as customer surveys indicate.

2.18 The sheer diversity of lenders renders it difficult to adopt a one size fits all approach to regulation. We are nonetheless very actively engaged in discussions with interested parties on how to make the sector work better for consumers.

[108] Not printed here

3. Specific Areas of Relevance for the Committee

3.1 We believe that there are a number of common misunderstandings about the short-term credit sector generally and, on occasion, about the service we provide. Among the most common misunderstandings recounted are the following:

- that customers are not provided with clear information of the cost of short-term loans
- that customers are charged annual interest of several thousand percent on their loans
- that loans are made irresponsibly by short-term lenders without proper prior checks
- that short-term lenders target people of low incomes, who cannot afford such loans
- that taking out a short-term loan can damage one's credit rating and thereby prevent or restrict the ability of applicants to access other mainstream credit providers
- that customers often have to pay back 10, 20 or 100 times what they have borrowed
- that the sector is not formally regulated and without any supporting industry codes of conduct for the sector or, if there are such codes, that they are ineffective

3.2 Although we can only speak for ourselves rather than for the short-term credit sector as a whole, containing as it does a wide range of providers as indicated above, we believe that none of these allegations applies in our own case. We further believe that many of the concerns raised with regard to the sector as a whole have often been overstated. Where there have been practices that may give rise to any concerns, we believe these can and are being addressed under the existing legal and regulatory framework.

Information and transparency

3.3 As indicated above, we aim to provide clear and total transparency as to the cost of our short-term loans. Our website makes very clear the total cost of any loan, including both interest and charges—as can be seen by accessing our website at: www.wonga.com. This is in addition to the information on APR rates.

3.4 We believe most other short-term lenders also provide a reasonable degree of transparency. However, in so far as the Committee may have any concerns on this, we would welcome a recommendation that those operating in the short-term credit sector should provide clear, up-front information as to the total cost of loans—including both interest and charges—prior to any application being approved. This would be in addition to the information on APR as currently required by law. We believe that all participants should inform customers of the total cost of borrowing before they commit, in a clear and transparent way—and that this should apply equally to bank overdrafts and credit cards.

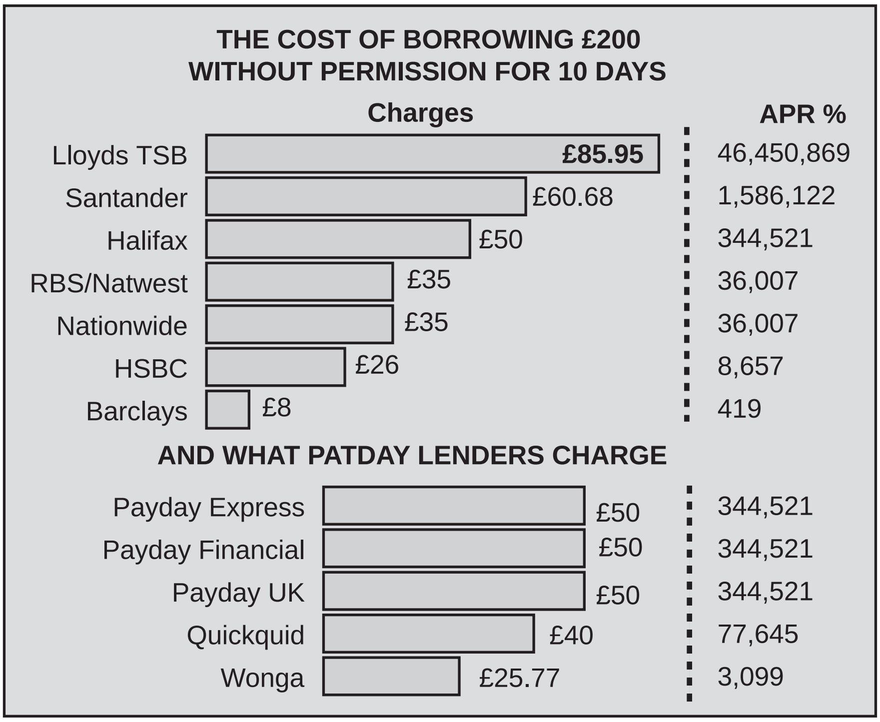
3.5 With regard to banks we note the headlines from a BBC Radio 4 Money Box programme at the weekend:

> *"Some High Street banks are charging "eye-watering" rates of interest when their customers go over their limit, research by Radio 4's Money Box programme has revealed. A customer borrowing £100 for 28 days without the consent of Santander would repay £200, for example. That is the equivalent annualised percentage rate, or APR, of 819,100%."*

APR—a misleading measure

3.6 It is a requirement under both the terms of the Consumer Credit Act and the relevant EU consumer credit legislation that short-term lenders must state a 'representative' annual percentage interest rate, calculated on a compounded annualised basis, even where they do not in fact offer loans on an annualised basis. This requirement, dating back to the original Consumer Credit Act in 1974, results in considerable distortions, with an apparent annual interest rate of several thousand percent in our case and for other short-term lenders—and even higher APR figures for the cost of unauthorised overdrafts (a much more common form of short-term credit) from the mainstream banks.

3.7 This distortive effect has been commented on by parts of the media, including newspapers who are sometimes critical of the short-term lending sector, as the following example (from the *Daily Mail* newspaper last year) illustrates:



3.8 Many of those concerned with the sector, including some who are critical of it, have also recognised that a measure which assumes the customer is borrowing for 365 days and that interest is compounded on a daily basis is not an appropriate measure for short term credit. Even if it were possible to borrow for Wonga for one year—which it is not—the actual interest charged of just under 1% per day would in fact result in an annual interest charge of 360%, not over 4000 % (which is the impact of the requirement to show a representative APR). The existence of very high APR rates is good for publicity purposes for some of those critical of the industry, as opposed to more thoughtful critics who recognise the problem, but it bears little resemblance to reality. Indeed, there is some evidence that very high APR rates, confuse the public rather than assist them.

3.9 This issue is a concern for all short-term lenders. The Committee may wish to consider whether APR remains a valid measurement elsewhere.

Avoiding irresponsible lending

3.10 We have set out above in the earlier part of this submission the extensive checks that we make prior to approving any loan. We would argue that the making of such prior checks is both in the industry’s interest—to avoid making loans to those unlikely to be able to repay them—and in the consumer’s interest—to avoid piling additional short-term debts onto those who already face long-term financial difficulties.

3.11 We are aware that there is a range of approaches taken by companies in the sector to paying for and returning data to the main credit bureaux. This is an area where the Department for Business, Innovation & Skills (BIS) is looking for best practice, which we support—and where the key is that data is provided in a timely manner direct to the main recognised credit reference agencies. We would support any recommendation to encourage their wider use by those in the sector. In addition, as part of the ‘mydata’ initiative being undertaken by BIS, there is more that can be done to help all borrowers understand and have access to their credit rating—and we are in active discussions with BIS on contributing to this project.

3.12 We share the concern not only that customers might be encouraged to borrow more than they can afford—hence the importance of proper credit checking beforehand—but also that a short term product designed for occasional use can become a long term product by virtue of unrestricted rollovers. Although we have previously declined to provide any extensions at all, we recognise it can be in the consumer interest to be able to apply for a short extension at particular times. However, we believe a balance should be struck, whereby (a) short-term credit providers never pro-actively encourage such extensions by their customers, but only consider them in response to specific requests being made by customers themselves; and (b) a limit on the number of such extensions is in place. We would welcome the Committee’s views on this issue and its support for such a general policy.

3.13 Wonga does not target any particular group of customers and our customer research indicates that our customers, all of whom must have a bank account and a fully functioning debit card and the majority of whom also have internet access, have access to other mainstream credit products. We recognise that some short-term lenders, including the providers of home credit, may have other approaches. This is a difficult subject on which to regulate, since the alternative to short-term loans for those on low incomes—who (unlike our own customers) may have limited access to traditional banking services—may be illegal money lenders, whose methods of enforcement are of a different order to any of the legal and regulated short-term lenders. We nonetheless believe that all short-term lenders should make proper checks before authorising any loan, to whomever it is made.

3.14 In this context, it should be noted that the use of credit reference agencies, as practised by ourselves, allows users of short-term credit to enhance, rather than damage, their credit rating. Far from preventing or restricting the ability of short-term credit applicants to access other mainstream credit providers, the greater use of credit reference agencies would help enhance customers' access to all forms of credit provision.

Limiting arrears—and help for those in difficulty

3.15 Borrowers must behave responsibly in terms of whom they lend to and how they deal with customers in financial difficulty. We believe all short-term lenders should subscribe to the services of the Consumer Credit Counselling Service (CCCS) and work with the other debt advisory charities in a pro-active way. We also believe that all lenders should respond constructively and proactively to those in hardship—in particular, by freezing interest on those who do fall into arrears, so that debts cannot mount up indefinitely, and agreeing sensible repayment plans with the assistance of the CCCS and other such bodies.

3.16 We currently limit interest on those who do fall into arrears to 60 days. We believe there is scope for all credit providers, including the banks, to adopt such a policy to prevent debts from multiplying excessively—and we would welcome the Committee's views on whether this should occur more generally.

Regulation, enforcement and non-compliance

3.17 The short-term credit sector, in line with the rest of the consumer credit sector, is presently regulated by the Office of Fair Trading (OFT). All operators in the sector must be licensed by the OFT, which has the power to suspend or withdraw licences in the event of dishonest trading or other serious breaches of the law. As the Committee will be aware, there are proposals under consideration by the Government for this responsibility to be transferred in due course to the new Financial Conduct Authority (FCA).

3.18 A real concern for customers and the legitimate companies operating in the sector is the ease with which unauthorised lenders can set up offshore. Furthermore, the OFT arguably lacks resources to deal with those companies who are not complying, particularly licencees who knowingly display misleading APRs or make unsubstantiated claims about their products, even when the OFT is alerted to this. We would welcome the Committee's views on whether the OFT (or the FCA in the event of its succeeding as the lead regulator in this sector) should have additional resources made available.

Effective Codes of Conduct vs. statutory controls

3.19 We support the work being undertaken by BIS to get the industry to produce Codes of Conduct with minimum standards. We believe that this is a practical way of ensuring that customers are protected. Both the FLA (our own trade association) and the Consumer Finance Association (CFA), which represents other short-term lenders, have their own Codes of Conduct. These can no doubt be improved further—and indeed the FLA has indicated that it is currently working on an updated Code of Conduct. We have indicated throughout this submission a number of areas where we believe industry conduct could be improved in the interests of consumers. We already seek to operate to best practice standards in terms of our operations and our own Code of Conduct, but we would welcome both the Committee's and the Government's support for improved overall standards.

3.20 There is already a significant body of legislation, guidance notes and European Directives concerning Consumer Credit and we do not believe that adding further regulation is practical given the wide range of companies engaged in the sector. We are aware of the discussion concerning price controls and we share the concern expressed by others. The evidence from customers is clear that we are competing with bank overdrafts and credit cards, yet we have not seen any suggestion that their pricing should be so controlled.

3.21 Previous Governments, including the last Government, along with the OFT have looked at the issue of statutory controls and found it likely to be counter-productive. The present Government has nonetheless recently commissioned further research into a proposal to cap not only the interest rate charged by short-term lenders but also other charges. We believe that the Government will wish to see the outcome of this new research before reaching any definitive decision on whether such a cap would be sensible.

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