



**Consumer  
Focus**  
Campaigning for a fair deal

# Affordable credit

Lessons from overseas

A report prepared for Consumer Focus by the Personal  
Finance Research Centre (PFRC) University of Bristol



# 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.

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## The researchers

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This report was prepared by Dr Chris Deeming, Sharon Collard and David Hayes at the Personal Finance Research Centre (PFRC), an independent social research centre based at the University of Bristol. PFRC undertakes rigorous empirical studies across a range of personal finance issues.

Recent studies completed by the Centre include an evaluation of the Money Guidance Pathfinder for the Consumer Financial Education Body (CFEB), a review of international pension reform for the Department for Work and Pensions (DWP) and an age-seven evaluation of the Child Trust Fund for HM Revenue & Customs (HMRC).

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# Foreword

We all borrow money at some point and the British propensity to do so is striking in comparison to our European neighbours. We borrow about twice as much as people in France and Germany with only Cypriots ahead of us in the European Union (See table 5 of the report).

This is not necessarily a 'bad thing'. At the macro level it needs to be seen in the context of how the overall economy is performing and at the micro level many of us manage debt very well and sensibly. However, for those on the lowest incomes, borrowing is not always a discretionary activity and they can pay a high, sometimes crippling, price. The high cost of credit is not a subject which we can ignore.

Problems associated with high cost credit are going to grow. We have experienced a period of historically low interest rates but the prospects are for increases. Moreover, incomes are falling and prices are going up. Household debt is predicted to rise to fill the gap.<sup>1</sup> For most households, credit will come from overdrafts, credit and store cards and personal loans. These forms of credit can be expensive for consumers, but, for those on the lowest incomes, often the only option is high-cost credit from non-mainstream lenders, such as home credit or payday loans. This means the people with the least money may need to take out credit at the highest rates. Disadvantaged consumers may become trapped in a cycle of debt. No society which wishes to maintain social cohesion can afford to ignore these problems.

Consumer Focus has a history of contributing to the debate on practical measures to make credit more affordable for disadvantaged consumers, both in terms of arguing for the commercial market to work better and for alternative provision through institutions such as Credit Unions. In 2009, Consumer Focus Wales produced *The cost of cash* which made important recommendations to private, third sector and public bodies.

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 findings are timely as the Government is currently considering how it can reform the British consumer credit market to make sure it is fit for the future.

The report's conclusions reflect the range of challenges facing private, third sector and public institutions and the necessary interrelationships between the players. There are no easy answers. This is a complex area requiring innovative solutions and, despite the different regulations and financial climates and cultures of other countries, we feel there is considerable value in drawing on the ideas and experiences of other nations in trying to reach our own national solutions.

France, Germany and Australia were the countries chosen for comparison with the UK. France and Germany have interest rate caps and very little sub-prime lending. This results in lower interest rates, but more limited access to credit for low income groups.

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<sup>1</sup> Office of Budget Responsibility, March 2011, Household Debt Forecast

Australia's system of financial regulation is nearer to the UK's and Australian society is also currently caught up in a debate about whether a national interest rate cap should be imposed. Rate caps might deter high cost commercial lenders, but removing supply will not eliminate demand and could push people on low incomes into the arms of illegal lenders. Low income consumers often need credit to juggle competing demands on limited budgets or to manage emergency expenditure.

When faced with calls for caps on rates, the reason cited by many for high interest rates is the need to reflect the cost of lending. Our financial regulators have the duty to ensure that the credit market for all of us is working well, ie the interest rates we are charged are set in a competitive market and are reflective of the costs of lending. This matters to us all but is particularly critical for those on low incomes.

Financial institutions have reduced the number of consumers without bank accounts by half in recent times but in itself this does not solve the problems of unaffordable credit as many of these accounts do not include credit facilities. There also remain about 1.75 million people without a transactional bank account. Growing support for Credit Unions has been an encouraging development. So while we welcome the progress made by financial institutions, more can be done and will need to be done if we are to support those on the lowest incomes in the interest of social cohesion.

Beyond the need to make sure the market is working properly, we need to consider providing affordable credit at below market rates, ie increased provision of low or no interest credit options through government, the financial services industry and third sector providers.

We must broaden the debate to include practical solutions that will provide access to affordable credit to low income consumers. Such solutions may involve partnerships between commercial, third sector and public bodies. For example in Australia, mainstream banks are working in partnership with charitable organisations to grant low cost loans to low income consumers.

The Government has played a role through initiatives such as the Social Fund and the Growth Fund although they could only help a fraction of those reliant on high cost credit. In the current fiscal and political environment the arguments for provision of taxpayers' money face a high hurdle if they are to be supported. Such support comes at a cost but we need to balance it against the costs of not taking action. As a society, we are not at ease with high cost credit<sup>2</sup> and Consumer Focus, along with many others, is keen to find affordable alternatives for people on low incomes. This is no easy task.

We think the UK could learn from experience in other countries, and commissioned this report by the Personal Finance Research Centre to see how affordable credit in the UK could be changed. We hope this research will stimulate ideas that push the debate beyond interest rate caps and towards affordable credit solutions for the poorest in our society.



**Mike O'Connor CBE**  
Chief Executive

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<sup>2</sup> A Yougov poll in August 2010 commissioned by Compass and Trident Reach found 68 per cent of people interviewed supported an interest rate cap to cover all forms of consumer credit (<http://bit.ly/nlxn8e>)

# Affordable Credit: Lessons from overseas

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Final report

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## Abbreviations

APR	Annual percentage rate
ASIC	Australian Securities and Investments Commission (Australia)
BIS	Department for Business, Innovation and Skills (UK)
CCD	Consumer Credit Directive (European Council)
CCSF	Comité Consultatif du Secteur Financier (French, independent economic research institute)
CDFIs	Community Development Finance Institutions (Australia)
DTI	Department of Trade and Industry (UK) (now BIS)
ECRI	European Credit Research Institute
FIT	Financial Inclusion Taskforce
GDP	Gross Domestic Product
IFF	Institut für Finanzdienstleistungen (German, independent financial services research institute)
IRR	Interest Rate Restrictions
JRF	Joseph Rowntree Foundation (UK, independent charitable trust)
NCCP	National Consumer Credit Protection Act (Australia)
NILS	No-interest loans scheme
OECD	Organisation for Economic Co-operation and Development
OFT	Office of Fair Trading (UK)
PFRC	Personal Finance Research Centre (UK)
UCCC	Uniform Consumer Credit Code (Australia)
ZEW	Centre for European Economic Research (German, economic research institute)

## Executive summary

Consumer Focus commissioned the Personal Finance Research Centre (PFRC) to examine and report on how the UK can most effectively ensure the provision of affordable credit to people on low incomes, particularly within the context of the available evidence on affordable credit emerging from other major OECD economies of France, Germany and Australia.

The Conservative–Liberal Democrat coalition government is currently consulting on how it might reform and strengthen the British consumer credit market to ensure it is fit for the future (HM Treasury 2010). This review suggests tentative conclusions under seven broad headings:

**Financial inclusion:** The comparative evidence on financial inclusion in the EU suggests that more needs to be done to improve levels of financial inclusion in the UK. The European Commission’s measure of ‘financial inclusion’ is based on data from 2003, however, and urgently needs to be improved and updated. Since 2003, banking inclusion in the UK has increased considerably, although there remain concerns about the use that people on low incomes make of their accounts.

**Information:** Consumers need good reliable information to make informed decisions when deciding to take out a loan or other credit product. Information provided by lenders on interest rates and fee structures needs to be clear, reliable and understandable.

The UK credit market would operate more efficiently if consumers had reliable documented credit histories, and the OFT argues that new systems are required in the UK to achieve this. The lending regime in Germany, for example, is underpinned by a comprehensive national credit reference database with exceptionally wide coverage and social acceptance.

Financial capability is about managing money, making decisions and planning ahead. Greater efforts are required to improve and measure the financial capability of consumers with financial literacy programmes and the like which build on recent efforts to promote the financial capability of consumers in the UK. A baseline survey was conducted in 2005 and a follow-up survey is now required to track changes in people's financial capability within the UK.

**Monitoring and regulation:** The UK needs to foster a culture of fair and responsible lending. The credit industry in the UK could do more to establish clear and accepted codes of practice among suppliers of credit; there is a clear role for better self-regulation by the credit industry. There is also a good argument for improved monitoring of the credit sector in the UK; the OFT or successor body is well placed to perform an expanded oversight and reporting role. Whether the UK requires interest rate restrictions or caps is currently a matter for debate; the

issue appears complex, the evidence that is available on the effects of caps in France and Germany is openly disputed. Here we shy away from any straightforward answers. Clearly there is a danger that the sub-prime credit market in the UK may suffer if caps are introduced. However the evidence about the impact of interest rate restrictions on credit access for people on low incomes is suggestive, drawn from other countries such as France and Germany with very different credit histories and cultures, so that simply extrapolating alternative models of credit to the UK context is far from straightforward. It is possible that interest rate restrictions, if introduced in the UK, might reduce access to credit for low-income consumers but many, such as the organisations under the Better Banking campaign umbrella, argue that the quality of credit is not good if it is not affordable for low income consumers. There is a need for more reliable information to help shape the debate on interest rate restrictions; this could take a number of forms and could include more public debate about the (appropriate) balance to be struck between the real risks and costs of credit for lenders and low income consumers in the UK. Evidence on the strength of public views and opinion on high-cost credit lending and the support for interest caps in UK is weak and inconclusive. New research could objectively engage UK public opinion on these issues and public opinion surveys in particular.

**High street banks and building societies:** There is a strong and credible argument that high street banks in the UK could do much more to make affordable credit available to those on low and minimum incomes. In Australia, major banks have teamed up with leading charities, and with the help of government funding they have been able to offer affordable credit loans to low income families in Australia. The Australian experience offers valuable lessons for thinking about how to promote affordable credit in the UK and a better dialogue with UK banks is needed about the potential nature and scope of social responsibilities.

**Social Banking:** The UK Coalition government's vision for developing a 'Big Society' should be welcomed with the promise of investment in social innovation and the third sector. In order to be a success, this is likely to require renewed commitment and investment from the British government. The UK urgently needs continued and improved investment in social lending through credit unions, community development finance institutions and other community-based organisations.

**Choice:** Low income consumers in the UK need improved choice of affordable credit options. New third sector partnerships with government and industry are now required to offer affordable credit and social banking options for low income families.

**Living standards:** There is a plausible argument that the government could do more to ensure that families in Britain live above the minimum level of income that the British public finds acceptable to maintain a decent standard of living. Ensuring that families receive a decent income for healthy living may also help to reduce levels of credit dependency which we see among low income families in the UK.

# 1 Introduction

## 1.1 Background

Consumer Focus commissioned the Personal Finance Research Centre (PFRC) to examine and report on how the UK can most effectively ensure the provision of affordable credit to people on low incomes, particularly within the context of the available evidence on affordable credit emerging from other major OECD economies of France, Germany and Australia.

‘Affordable credit’ has been defined as one of the key elements of ‘financial inclusion’ (see Box 1) (Collard and Kempson 2005; Collard 2007). Along with access to banking and debt advice, it was one of the three priorities for UK government policy from 2004 to 2011. It is perhaps too early to comment on the position of the new Conservative–Liberal Democrat coalition government which is currently consulting on how it might reform and strengthen the UK consumer credit market to ensure it is fit for the future (HM Treasury 2010). It has been estimated that at least 9 million people in the UK are excluded from mainstream credit provided by banks and building societies and while there have been government initiatives like the DWP Growth Fund in recent years, it is argued by campaigners that access to affordable credit has not been tackled to the same extent as access to a bank account (NEF 2009; Pomeroy 2011). The Office of Fair Trading (OFT) warns that addressing the issues relating to high-cost credit would require a fundamental rethink of policy in this area, which will almost certainly require greater involvement of mainstream financial institutions in this market and/or considerable investment in social lending (OFT 2010).

### Box 1: Key concepts in this report

**Financial exclusion:** The concept of financial exclusion has been the subject of increasing interest and debate and is characterised as a situation where a proportion of the population have limited access to mainstream financial services (Devlin 2005; Collard 2007).

**Financial capability:** Financial capability is about managing money, making decisions and planning ahead (Atkinson *et al.* 2006).

**Credit exclusion:** Credit is a financial tool to enable access to goods or expenditures that cannot be accommodated in the weekly or monthly budget, such as a washing machine or furniture. It may play a significant role to smooth consumption and to protect against income shocks (European Commission 2008). Those who cannot access credit either because it is unavailable or it is unaffordable may be said to be excluded from credit.

**Affordable credit:** In this inquiry ‘affordable credit’ means credit that is affordable and appropriate for people on low and minimum incomes (Collard and Kempson 2005).

**Interest Rate Restrictions and Caps:** Absolute caps on the total cost of credit or relative rate ceilings; fixed administratively, by statute or court rulings as laws designed to prevent exploitation and unfair competition with effects on credit cost.

Measuring ‘credit exclusion’ and the numbers excluded from credit at the population level is fraught with difficulty; there are issues to do with structure and process in the finance sector as well as issues to do with personal choice and preference to consider, the latter is often referred to as ‘individual agency’. Information relating to credit applications, rejections and exclusion is usually commercially sensitive and tends not to be in the public domain. At the same time information systems are unlikely to be in place to capture and record the full range of activities and practices that we see in the rapidly changing sub-prime sector in Britain. There are also other nonbank forms of credit to consider, some of which may be ‘invisible’ in the sense that, for example, mail order or moneylenders do not operate out of local offices but rather they carry advertisements in newspapers, magazines and the internet for credit without credit checks; these lenders are more embedded within social and community networks of the sub-prime market.

Banks and building societies may exclude people from ‘mainstream’ credit loans because they are perceived to be non-profitable high risk customers, a particular problem for people on low incomes. There are also the customs and practices of individuals with regard to their financial management; issues of ‘agency’ or personal preference often arise as individuals themselves may choose to avoid involvement with lenders and may therefore exclude themselves from the credit market out of choice. The ‘mainstream’ banking culture, for instance, may alienate low income households or the formal credit-assessment procedures may put off low income households who may just assume they will be rejected. On the one hand then we have institutionally led processes of financial exclusion, and on the other there is the individual or household perspective where cultural traditions, custom, and practice govern the use of financial resources. When it comes to measuring credit exclusion at the country level it is extremely difficult to separate out the underlying causes and interplay between individual choices and financial structures and processes.

## **1.2 Outline of the report**

This report for Consumer Focus examines how the UK can take steps to most effectively ensure the provision of affordable credit to people on low incomes. To achieve this we draw upon the international research literature and consider in Section 2 some of the major research priorities and issues relating to the provision of affordable credit which have occupied researchers in recent years. There is a large international literature covering the regulation of credit markets and numerous empirical studies focusing on the impact of interest rate restrictions. In Section 2 we also consider relevant survey data collected by the EU and OECD, especially that relating to levels of financial exclusion, the value of consumer credit markets and consumer over-indebtedness. Section 3 examines the credit sector in the

UK and other selected OECD countries of France, Germany and Australia. In this section we provide a review and appraisal (from the perspective of financially inclusive social policy) of the consumer credit markets, the regulatory and public policy frameworks and social innovation in the credit sector within our reference countries.

The European Commission has undertaken a number of opinion surveys and stakeholder consultations relating to the provision of affordable credit, as have other agencies and these are considered in Section 4. In Section 5 we report the results of a small number of investigative interviews undertaken by PFRC with key stakeholders in the UK, France and Australia. Finally, in Section 6, we consider proposals for improving the provision of affordable credit to people on low incomes in the UK, and we identify areas where the research evidence is weak and where there are particular gaps in our knowledge.

## 2 Research literature: An overview

### 2.1 Identifying relevant research literature

Numerous empirical studies have been devoted to examining and evaluating the provision of affordable credit. Often, and especially in this literature, we need to be careful about generalising from one context to another. A strand of work that is particularly relevant here are studies looking at the impacts of interest rate restrictions on credit markets. Many of the studies are idiosyncratic to particular times and/or country settings which can often render generalisations to the UK context problematic as we shall see.

### 2.2 Summary: themes and issues

#### 2.2.1 *Financial exclusion and capability*

Levels of financial exclusion vary widely in EU countries as analysis by the European Commission (2008) indicates (see Table 1). Drawing on Eurobarometer Survey data, which was collected at the end of 2003, the European Commission considered people aged 18 plus who lacked a bank account of any kind (transaction or deposit), a savings product or credit (including overdrafts, credit and charge cards and loans) to be financial excluded. According to the European Commission report, the UK experiences much higher levels of financial exclusion compared to other major economies like France and Germany.

The figure based on the Eurobarometer data suggests six per cent of the UK population were financially excluded at the time of the survey. More recent survey data indicates that the number of adults living in households without a transactional bank account has decreased in recent years, however, although issues around bank account usage remain a concern (Financial Inclusion Taskforce 2010). It is important therefore to note that the Eurobarometer data is useful to draft a broad picture and to be able to draw very rough international comparisons but is now eight years old and needs to be updated. For instance, some of the experts who responded to a recent European Commission consultation on basic bank accounts believe that the current financial crisis has resulted in many people becoming excluded, and that previous *over-inclusion* (i.e. access to high levels of credit) may now accentuate levels of financial exclusion.

**Table 1: Financial exclusion in the EU (25 countries rank ordered)**

	% financially excluded
Luxembourg	<1
Belgium	1
Denmark	1
Netherlands	1
<b>France</b>	<b>2</b>
Sweden	2
<b>Germany</b>	<b>3</b>
Austria	3
<b>UK</b>	<b>6</b>
Finland	6
Slovenia	6
Spain	8
Ireland	12
Italy	16
Estonia	16
Portugal	17
Czech Rep	17
Cyprus	18
Malta	21
Slovakia	26
Greece	28
Hungary	34
Poland	40
Lithuania	41
Latvia	48

Source: European Commission (2008: 20, using 2003 data).

The UK, France and Germany represent the EU countries with the largest national consumer credit markets; we also include another comparable OECD country in this study: Australia (see Section 3.5). Germany and France have very different consumer credit regulations to the UK, in that they have interest rate restrictions. The UK market is comparable to that of Australia and, like the UK, Australia does not currently have (national) interest rate restrictions. Like the UK, Australia also finds itself grappling with issues to do with affordable credit. Scandinavian countries offer very different systems of welfare capitalism and are not well placed for drawing comparisons with the UK on the issue of affordable credit (Esping-Andersen 1990; Abrahamson 1999; Goodin *et al.* 1999; Arts and Gelissen 2002).

More detailed results from the Eurobarometer survey are provided in Table 2, which covers credit exclusion and Table 3, which reports the proportions of people who do not have a basic bank account at all (i.e. the unbanked), those who do not have transaction banking services and those who are 'marginally banked' (i.e. covering those with deposit accounts but with no payment card or cheque book).



**Table 2: Levels of revolving credit and savings exclusion in the EU (25 countries rank ordered)**

	No revolving Credit %	Have a loan(s) %	No savings %
Luxembourg	18	35	28
Belgium	37	17	13
Denmark	18	35	15
Netherlands	21	11	28
<b>France</b>	<b>14</b>	<b>21</b>	<b>39</b>
Sweden	33	22	7
<b>Germany</b>	<b>46</b>	16	<b>21</b>
Austria	36	21	11
<b>UK</b>	<b>30</b>	<b>24</b>	<b>22</b>
Finland	48	23	34
Slovenia	36	23	32
Spain	46	16	25
Ireland	51	34	21
Italy	56	13	50
Estonia	80	7	67
Portugal	75	12	62
Czech republic	62	14	35
Cyprus	54	33	24
Malta	70	9	30
Slovakia	81	13	40
Greece	76	9	41
Hungary	78	11	58
Poland	73	11	60
Lithuania	86	6	61
Latvia	80	8	76

Source: European Commission (2008: 27, using 2003 data).

Analysis carried out for the European Commission (2008) showed that 30 per cent of British adults had no credit facilities, which is broadly consistent with other research reporting 26 per cent of households had no credit facilities (Kempson 2002).

The number of British adults living in households without a transactional bank account has decreased in recent years. The most recent figures for 2008/09 indicate that three per cent of the adult population in Britain are unbanked (Financial Inclusion Taskforce 2010); less than half of the figure reported by the European Commission (nine per cent). This is an encouraging finding. It suggests that work by industry to make basic accounts available continues to drive reductions in adults without access to banking, as the Financial Inclusion Taskforce (2010) observes.

**Table 3: Levels of banking exclusion in the EU (25 countries rank ordered)**

	No transaction bank account %	Marginally banked %	Unbanked %
Luxembourg	11	6	6
Belgium	5	3	3
Denmark	11	7	5
Netherlands	2	<1	2
<b>France</b>	<b>4</b>	<b>1</b>	<b>3</b>
Sweden	17	9	8
<b>Germany</b>	<b>7</b>	<b>2</b>	<b>5</b>
Austria	20	11	9
<b>UK</b>	<b>15</b>	<b>6</b>	<b>9</b>
Finland	18	6	11
Slovenia	13	2	11
Spain	42	30	11
Ireland	41	21	19
Italy	26	7	19
Estonia	35	8	27
Portugal	20	2	18
Czech Rep	40	11	29
Cyprus	48	19	29
Malta	51	27	25
Slovakia	48	12	37
Greece	78	42	36
Hungary	49	6	43
Poland	58	2	56
Lithuania	65	12	53
Latvia	65	3	62

Source: European Commission (2008: 22, using 2003 data).

We know certain sections of the population are more at risk of financial exclusion of which credit exclusion is part. Research by the European Commission (2008) shows that women in Europe are more likely to be completely financially excluded than men (see Table 4). Young people (aged 18-25) and adults aged 65 and over are most likely to be financially excluded. Younger people are the group most likely to be excluded in EU 15 countries, while in new member states it is most common among older people. Lone parents and single people (who tend to be either quite young or quite old) include a greater proportion of who are financially excluded. There is a strong link between financial exclusion and level of education received and also with income. Less well-educated and lower income households are more likely to be excluded from all forms of financial services.

**Table 4: People likely to experience high levels of financial exclusion in the EU (EU15)**

	High level of financial exclusion %
All	18
<b>Family Type:</b>	
Lone parent	24
Couple with children	10
Single no children	22
Couple no children	17
<b>Respondent Work Status:</b>	
Self employed	8
Employed	8
Looking after home	30
Student	38
Unemployed	33
Retired/unable to work	20
<b>Age left education:</b>	
up to 15	24
16-19	13
20+	7
Still studying	38
<b>Gender:</b>	
Male	14
Female	21
<b>Age:</b>	
18-25	33
26-44	12
45-64	12
65+	25
<b>Geographical area:</b>	
Rural area or village	20
Small or middle sized town	17
Large town	16
<b>Household income:</b>	
Lowest income quartile	32
2nd lowest quartile	13
2nd highest quartile	14
Highest income quartile	8

Source: European Commission (2008: 32).

‘Financial capability’ is about managing money, making decisions and planning ahead. A full national survey to measure levels of financial capability in the UK was conducted between June and September 2005 and this found clear indications that individuals may be particularly capable in one or more areas of financial capability, but lack skills or experience in other areas (Financial Services Authority 2005; Atkinson *et al.* 2006). The domains of financial capability were identified as ‘managing money’, ‘planning ahead’, ‘choosing products’ and ‘staying informed’. A follow-up survey is needed to track changes, and progress, in people’s financial capability within the UK. Unfortunately, there is no comprehensive data at present that allow us to examine financial capability across the EU or against our selective reference countries of France, Germany and Australia.

## 2.2.2 Credit markets

Table 5 shows the total value of consumer credit in EU member states in 2008. These statistics cover consumer credit advanced to all types of households including credit card loans and overdrafts. The UK has one of the largest credit markets in the EU with a vast range of financial products available to consumers. The value of this market is estimated at 16 per cent of GDP; in comparison the French credit market is valued at eight per cent of GDP and the German markets nine per cent of GDP.

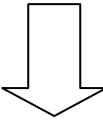
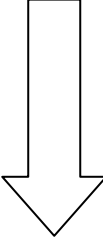
**Table 5: Total value of consumer credit in EU member states**

Member State	Consumer Credit as a % of GDP	Consumer Credit (billions of Euros €)
Cyprus	25.1	4.3
<b>UK</b>	<b>16.2</b>	<b>245.2</b>
Romania	14.6	18.3
Bulgaria	13.9	4.7
Hungary	12.9	12.9
Greece	12.9	31.4
Poland	10.8	32.8
Ireland	9.8	18.2
Portugal	9.3	15.5
Spain	9.3	102.3
<b>Germany</b>	<b>9.0</b>	<b>224.1</b>
Austria	8.4	23.84
Denmark	8.1	19.0
<b>France</b>	<b>8.0</b>	<b>155.7</b>
Slovenia	7.8	2.9
Italy	6.5	101.8
Finland	6.5	12.1
Malta	5.8	0.3
Belgium	5.5	19.0
Estonia	5.3	0.8
Latvia	4.9	1.1
Sweden	4.6	13.3
Czech republic	4.6	6.3
Netherlands	4.0	23.8
Lithuania	3.9	1.3
Luxembourg	3.2	1.2
Slovakia	2.5	1.7

Source: OFT (2009a: 26).

The OFT, drawing upon survey data for 2007, has also ranked European sub-prime lending markets. Accordingly, the UK has one of the most ‘developed’ sub-prime credit markets in the EU; the French and German markets appear relatively less ‘developed’ in comparison (see Table 6). In this context the terms ‘developed’ and ‘underdeveloped’ are simply used to refer to the size of the credit market with little assessment of the quality of the products being offered in the market. The ‘sub-prime sector’ tends to refer to lenders who operate in the riskier end of the borrowing spectrum, and sub-prime borrowers often include those who have previously been rejected by mainstream lenders for a variety of reasons such as poor credit history.

**Table 6: Ranking of European sub-prime lending market by degree of ‘development’**

Member State		
<b>UK</b>	Highly developed	
Ireland		
Spain		
Netherlands		
Belgium		
Portugal		
<b>France</b>	Somewhat developed	
Finland		
<b>Germany</b>		
Sweden		
Denmark		
Norway		
Italy		
Greece		
Austria		
		Undeveloped

Source: OFT (2009a: 27).

### 2.2.3 Regulation and interest rate restrictions

There is a large literature on regulation and interest rate restrictions and numerous empirical studies have been devoted to determining the economic impacts of rate caps. For example, natural experiments comparing different states in the US date back to the 19th century (e.g. Bodenhorn 2007). The findings of these studies tend to suggest that tighter interest rate restrictions result in lower credit access for low-income consumers as well as reducing the total amount of consumer credit available. Caps in the US tend to be set at low levels, while typical caps in the EU are higher, making it hard to extrapolate from the US to the European context (iff/ZEW 2010).

Drawing firm conclusions on the effects of interest rate restrictions from EU Member States such as France and Germany is much more challenging as we shall discover in Section 3. Credit markets are determined by a multitude of other economic and regulatory factors making it hard to draw firm conclusions. The evidence on the effects of interest rate restrictions in France and Germany is fiercely contested, not helped by the lack of reliable information on the availability of and use of affordable credit (e.g. NEF 2009; Gloukoviezoff 2011). Policy oriented reports and recommendations which draw on the experience of France and Germany are usually more theoretically-inclined than empirically driven; in the absence of clear evidence positions tend to diverge and are often value laden. To a large extent what various stakeholders are left arguing about in the contemporary context is whether the credit that is available to consumers is right for them. This is of course ultimately a moral question, as well as a question for consumers and the public, a point that unfortunately gets lost in the technical policy debates about credit models and interest rate caps.

#### **2.2.4 Stakeholder and public opinion**

Numerous surveys and stakeholder consultations on issues relating to financial inclusion and affordable credit for low income consumers have already been conducted in EU countries and indeed across the EU (e.g. European Commission 2009). The European Commission is currently consulting on interest rate restrictions and we consider this and other stakeholders consultations in Section 4. Some preliminary investigative interviews with stakeholders from the reference countries were also undertaken for this study and the findings are discussed in Section 5. Although a considerable amount of consultation work has already been completed, we note that there has been little appeal to public opinion in the UK on the issue of interest rate restrictions. If we accept that the issue of interest rate restrictions is a moral issue, at least in part, then it would appear prudent to gather UK public opinion in an objective way to inform this debate and future policy relating to credit market regulation within the UK. More work could be done to test general public opinion in this field, particularly the extent to which government should play a crucial role to address problems of access and use regarding credit and the strength of public opinion on this.

#### **2.2.5 Household indebtedness**

Over the past decade, household debt has risen to record levels in many OECD countries. The latest comparable data on household indebtedness comes from the OECD and relates to 2008 and 2009. In the UK, household debt (i.e. all household liabilities) appears relatively high, with a debt to income ratio around 171 per cent of disposable household income in 2009, of which mortgages accounted for the bulk (133 per cent) of the household debt (see Table 7). By comparison, household debt in the major economies of France and Germany is relatively low. France has a debt to income ratio at 107 per cent of disposable household income (mortgages accounted for 77 per cent of this) and in Germany household debt stands at about 99 per cent of disposable income (of which mortgages accounted for 67 per cent). It is difficult to comment on how low income families fair in relation to levels of household debt under the various systems of credit regulation, with interest rate restrictions and restricted access to credit, as household debt levels are not reported by household income level in this dataset. This should be a priority for future research and development as it help to shed further light on the impact of consumer credit market regulation in different countries (see Section 6.3).

**Table 7: Household indebtedness in selected OECD countries**

		1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
UK	Liabilities <sup>1</sup>	109.4	113.7	117.1	121.4	134.0	145.0	160.0	162.3	176.0	183.6	177.6	170.6
	of which: Mortgages	79.4	82.7	85.4	88.5	97.1	106.8	119.0	121.2	130.1	138.2	135.6	132.8
France	Liabilities <sup>1</sup>	72.5	75.4	76.8	78.0	75.6	79.7	83.7	91.0	96.5	100.3	102.3	106.6
	of which: Long-term loans <sup>2</sup>	51.5	53.8	53.4	53.6	54.6	57.1	60.2	65.3	69.5	73.2	76.6	..
Germany	Liabilities <sup>1</sup>	109.4	114.2	114.5	111.8	112.1	110.9	109.6	107.1	104.8	101.7	97.5	98.6
	of which: Mortgages	67.1	71.0	71.7	71.2	72.3	72.2	71.8	71.0	70.8	68.9	66.1	67.1
Italy	Liabilities <sup>1</sup>	45.5	48.8	52.8	52.3	58.3	62.3	66.7	71.9	75.7	79.2	79.8	..
	of which: Long-term loans <sup>2</sup>	24.6	27.3	28.5	28.3	33.6	36.3	39.9	43.7	46.2	48.6	48.6	..
Canada	Liabilities <sup>1</sup>	112.0	114.1	112.6	114.1	117.1	120.6	124.3	129.4	131.8	137.3	141.7	148.4
	of which: Mortgages	71.8	71.8	69.6	69.6	71.2	73.2	75.9	79.1	80.7	84.7	87.9	92.3
Japan	Liabilities <sup>1</sup>	132.5	133.4	134.5	135.9	133.6	133.6	131.4	131.8	130.4	127.4	127.2	..
	of which: Mortgages	56.0	58.9	61.0	63.1	62.8	63.9	63.4	64.1	65.2	64.9	64.7	..
US	Liabilities <sup>1</sup>	95.4	99.6	100.7	104.7	109.9	117.8	124.1	131.3	135.6	137.8	130.3	127.5
	of which: Mortgages	63.8	66.6	67.2	71.3	77.2	84.2	90.2	97.7	101.7	103.4	98.1	95.9

Notes:

<sup>1</sup>Liabilities are amounts outstanding at the end of the period, in per cent of nominal disposable income.

<sup>2</sup>Covering loans to households for house purchases.

Source: OECD Annex Table 58: Household wealth and indebtedness.

In Australia, the overall picture of household indebtedness is comparable to the UK, at 173 per cent of annual disposable income in 2005 (OECD 2006). Questions about over-indebtedness and ability the country/households to service this debt are complex and are beyond the scope of this project; such issues are discussed elsewhere (e.g. OECD 2006).

## 2.2.6 Minimum standards of living

There is a long history of research in the UK establishing the monetary costs of minimum living standards (e.g. Deeming 2010). In recent years pioneering work has looked at what members of the public think is a minimum acceptable standard of living in Britain (Bradshaw *et al.* 2008). The latest report suggests that many adults and families in Britain are living on incomes below what most British people feel is the minimum acceptable (Davis *et al.* 2010). According to recent research there have been falls in living standards for those on low-to-middle incomes in recent years and prospects do not look good going forward for such households, with the UK government committed to deficit reduction (Resolution Foundation 2010, 2011).

Many argue that the government should do more to raise the living standards of the poorest sections of society (e.g. NEF 2009; Dowler 2010), to ensure that families are living above the minimum level of income that the British public finds acceptable to maintain a decent standard of living. Such a move may also help to reduce levels of credit use among low income families in the UK although there appears little attempt by researchers to quantify this. If families are living with inadequate incomes and managing on the edge of their financial budget, they will turn to the sources of borrowing available to them.



## **3 The design, architecture and regulation of consumer credit systems in the UK, France, Germany and Australia**

### **3.1 Introduction**

The UK, France and Germany represent the EU countries with the largest national consumer credit markets. However, France and Germany have different consumer credit regulations to the UK and, in particular, different levels and forms of interest rate restrictions. The UK government does not impose interest rate restrictions on commercial lenders, but allows the credit industry more scope to regulate itself. In contrast, interest rate restrictions have been in place in France and Germany for a long time which makes them ideal for inclusion in this comparative study of affordable credit.

Another comparable OECD country with a significant credit market is Australia. Historically the Australian Federal (Commonwealth) Government has been reluctant to impose interest rate restrictions, preferring instead to devolve responsibility for regulating the credit market down to each of the states and territories. However in recent years the Federal Government has found itself grappling with the issue of market regulation as it attempts to make affordable credit more widely available. There is growing pressure for the Federal Government in Australia to take tougher action on high-cost short term lending practices and the government is currently reforming the sector. We consider the design and architecture of the consumer credit systems currently operating in the four countries in more detail below.

### **3.2 United Kingdom**

The UK has a strong economy with a GDP per capita of US\$35,630, a figure comparable to France, Germany and Australia (see Appendix 1). The UK population is 61.4 million. The total value of the consumer credit market was estimated at 16.2 per cent of GDP in 2008, valued at €245.2 billion (Table 5). The high-cost credit sector remains a significant and valuable sector of the economy; it includes pawnbroking, payday lending and other short-term small sum loans, home credit and rent-to-buy credit. In 2008, high-cost credit loans to consumers totalled £7.5 billion (OFT 2010b). Household debt in the UK is relatively high, the debt to income ratio stood at 170.6 per cent of nominal disposable income in 2009, of which mortgages accounted for 132.8 per cent of nominal disposable income (see Table 7).

### 3.2.1 Financial inclusion in the UK

The European Commission (2008) found that six per cent of the UK population were financially excluded in 2003; although recent data suggests that the UK has made significant progress in relation to the adult population in Britain who are unbanked. The figure now stands at three per cent of the population (Financial Inclusion Taskforce 2010), and this figure is comparable to the proportion of the adult population in France and Germany who are unbanked.

### 3.2.2 UK credit market and regulation

An innovative consumer credit market has developed rapidly in the UK over the last 30 years and this market is now one of the largest in the world (OFT 2010b). The UK sub-prime credit market remains one of the largest in the EU. A survey of consumers by the OFT (2010a) found that users of home credit are substantially overrepresented in lower social classes, have markedly lower income, lower levels of final educational achievement, a much higher proportion of single parents, and are substantially more likely to be unemployed or not in paid employment. Payday lending customers are more concentrated in the younger and middle year groups, they tend to be heavily concentrated in the range below median income but generally above the lowest income bands. Consumers who use payday loans and pawnbrokers find that this form of credit is not cheap, although they report a number of advantages such as quick and easy access (see Table 8).

**Table 8: Consumer attitudes and views on financial products**

Form of Finance	Quick to get	Easy to access	Easy to understand	Cheap	Trust myself/gives me control	Want to help me
Payday loan	✓✓✓	✓✓✓	✓✓	x	✓✓	✓✓
Credit card	✓	✓✓	✓✓	x	xxx	✓
Overdraft	✓	✓	✓✓	✓	xx	xx
Personal loan	x	xx	✓✓✓	✓	✓	xx
Credit Union loan	x	✓	✓✓✓	✓	✓	✓✓
Store cards	✓✓	✓✓	✓✓	✓	✓✓	✓
Car manufacturer finance	x	x	✓✓	✓✓	✓✓	✓
Pawnbrokers	✓✓✓	✓✓✓	✓✓	x	x	✓✓
Loan from friends or family	✓✓✓	✓	✓✓✓	✓✓✓	✓✓✓	✓✓✓
Key:	✓✓✓	✓✓	✓	x	xx	xxx
	Strongly Agree					Strongly disagree

Source: Burton (2010: 31)

For the most part, the UK credit industry acts in a responsible manner. The experience of some short-term 'payday' borrowers can be a positive one, provided the loan is paid off when it becomes due and is used on a one-off basis only (e.g. Burton 2010). However, there

has been a longstanding concern in the UK that some lenders are engaged in unfair practices to the detriment of consumers, the credit industry, and society as a whole (Secretary of State for Trade and Industry 2003; Consumer Focus 2009). There are concerns that consumers of high-cost credit, including many on low incomes, suffer from a lack of options when seeking credit, and that the price they pay for credit is too high. People on low incomes are especially vulnerable and susceptible to exploitation. Regulators such as the OFT and the Advertising Standards Authority (ASA) have been called upon to investigate business practices (see Table 9).

**Table 9: Regulation of the UK payday loans industry**

In April 2008, the ASA upheld a complaint against the payday lender, the Money Shop for using advertising which suggested that the use of high rate, short-term credit was suitable to fund aspirational, non-essential purchases such as a party, a shopping trip or a holiday. The ASA ruled that this was likely to be seen as encouraging carefree, impulsive and frivolous spending on credit and concluded that the advertisement could encourage consumers to spend borrowed money irresponsibly.

In October 2009, the ASA upheld a complaint against the online payday lender Quickquid, for failing to include the APR of 2,000% in its TV advert. The ASA ruled that the APR had to be disclosed as the advert emphasised the speed of the loan process and that this constituted an incentive for people to take up their offer.

In July 2010, the ASA upheld a complaint against online payday lender Wonga.com Ltd for portraying the act of taking out a loan in an overly whimsical fashion, including using laughter when the suggestion was made that a bank may offer a better alternative. The failure to give greater prominence to the APR than other information presented in the ad concerning the cost of borrowing also caused it to breach the Consumer Credit (Advertisements) Regulations 2004.

Source: [www.asa.org.uk/ASA-action/Adjudications.aspx](http://www.asa.org.uk/ASA-action/Adjudications.aspx)

One of the most recent requests to the OFT follows a complaint from Citizens Advice about firms cold-calling consumers by telephone and text to promote consumer credit products (OFT 2011).

The UK government has thus far resisted pressure to impose interest rate caps on for-profit lenders, preferring instead to promote responsible lending practices. Legislative reforms under the Consumer Credit Act were intended to make it easier for consumers to challenge agreements deemed to be unfair in the courts; however there is little evidence to suggest that consumers are better protected from abuses in the credit market nor have the reforms achieved their stated aims of providing a better mechanism for borrowers to challenge unfairness in the courts.<sup>1</sup> Those who face payments which are grossly exorbitant or otherwise grossly contravene ordinary principles of fair lending have sought redress in law, but some critics argue that existing provisions have not operated effectively (e.g. NEF 2009).

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<sup>1</sup>Citizens Advice, Responsible Credit Conference 20.10.10

In recent years the government has come under increased pressure to take tougher action on extortionate credit. For instance, the Better Banking campaign, which is lobbying for fair and affordable banking for all, has brought together some 500 organisations to call for fundamental reform of the banking system, and this includes a call for interest rate caps to help prevent extortionate lending.<sup>2</sup> The Better Banking campaign argues that banks should do much more to deliver a genuine social return to the people and communities they serve; the Better Banking campaign recommends that banks reinvest one per cent of their profits for social benefit. Recently, Stella Creasy MP has called for a total cost of credit cap and there was cross-party interest in the measure proposed (Creasy 2011). Still others strongly argue against such measures which they claim may damage the credit industry and therefore reduce access to credit for low income consumers (e.g. Policis 2004a; OFT 2010b; Friends Provident Foundation 2011). They are concerned that a cap on credit will lead more vulnerable consumers to resort to borrowing from illegal lenders ('loan sharks'), it is estimated that six per cent of residents in some of the most deprived areas borrow from 'loan sharks' (Ellison *et al.* 2010), or taking on forms of credit which they find difficult to manage and result in spiralling debt, due to penalty charges and fees for default. Instead they call on the credit industry to do more, and regulate itself better by establishing clear and accepted codes of practice and making available better information to consumers on the costs and risks of using high-cost credit. The OFT, for example, has made a number of recommendations (see Table 10), which they suggest would lead to incremental improvements in the UK's high-cost credit sector. The OFT warns, however, that addressing the issues relating to high-cost credit would require a fundamental rethink of policy in this area, which will almost certainly require greater involvement of mainstream financial institutions in this market and/or considerable investment in social lending (OFT 2010).

The UK government is currently consulting on the matter and considering a range of options for reforming the UK consumer credit market (HM Treasury 2010). Whatever the final outcome of the government consultation, the UK Coalition government under David Cameron has set out a vision for a 'Big Society',<sup>3</sup> which means that we are likely to see a much greater role for social innovation and an expanded third sector, and possibly renewed efforts to boost the social banking sector in the UK which we turn to next.

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<sup>2</sup><http://betterbanking.org.uk>

<sup>3</sup>[www.cabinetoffice.gov.uk/content/big-society-overview](http://www.cabinetoffice.gov.uk/content/big-society-overview)

**Table 10: OFT review of high-cost credit**

The recent review of high-cost credit in the UK by the OFT reported that the sector in the UK worked reasonably well but made a number of key recommendations:

- consumers need help to make informed decisions on high-cost credit, which means efforts to improve the financial capability of consumers with financial literacy programmes and greater efforts by industry working with others (including government) to provide better information to consumers on high-cost credit.
- new systems are required to help consumers to establish documented credit histories.
- there needs to be better monitoring of the high-cost credit sector, with oversight from OFT.
- more effort is needed to promote best practice and codes of practice among suppliers of high-cost credit.

Importantly, the OFT rejected the case for price controls for pawn-broking, payday loans, home credit and rent-to-buy credit; concluding that they would not be an appropriate solution to the particular problems found in the UK credit market (OFT 2010).

### **3.2.3 Credit for low income consumers and the UK social banking sector**

The UK has a well developed sub-prime credit sector, including a wide array of lenders and institutions that provide credit to those customers that mainstream lenders (such as the high street banks) would likely reject. These lenders are a major source of credit for those managing on low incomes who often take out loans to help make ends meet (Burton 2010). Many lenders are well established and reputable but there has been a longstanding concern in the UK that some lenders engage in unfair practices and news stories about poor families trapped in a cycle of debt often make headlines in the media. The Zacchaeus 2000 Trust, an independent UK charitable trust campaigning for social justice, has represented many vulnerable debtors with multiple problems to ensure that they are dealt with fairly and proportionately by the courts and often reports the outcomes of recent cases on its site.<sup>4</sup>

There is an argument that high street banks in the UK could do much more to make affordable credit available to those on low and minimum incomes. The New Economics Foundation (NEF), for example, argues that those on low incomes in France and Germany have much greater access to mainstream credit through the banking system than their counterparts in the UK (NEF 2009). We consider the credit markets of France and Germany in Sections 3.3 and 3.4. While in Australia, major banks have teamed up with leading charities, and with the help of government funding they have been able to offer affordable credit loans to low income families (albeit often with restrictions on the purpose of the loan, as we discuss in Section 5). The Australian experience offers valuable lessons for thinking about how to promote social banking in the UK and this is discussed in Section 3.5.

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<sup>4</sup>[www.z2k.org/](http://www.z2k.org/)

The British government has set out a vision for the 'Big Society' and with this we are likely to see a much greater role for social innovation and third sector provision (Cabinet Office 2010). As Shanmugalingam et al. (2011) observe, a new social investment industry is steadily taking shape in the UK, often referred to as social finance or the social economy. It fuses together two relative UK strengths, skills in finance and skills in civic action, organisation and delivery. The UK can expect to see a much greater role for social innovation and an expanded third sector, and possibly renewed efforts to boost social banking sector. As Consumer Focus recently noted, the UK urgently needs continued and improved investment in social lending through credit unions and community-based initiatives (Burton 2010). Low income families and consumers are increasingly likely to need opportunities to save small sums of money against future financial difficulty and borrow at affordable rates in times of crisis, particularly in the current tough economic climate characterised by falling living standards (Resolution Foundation 2010, 2011).

The UK government established the Social Fund over twenty years ago to provide interest-free loans and grants, mainly to people in receipt of income-related benefits (see Table 11). It makes provision for low income families to help them spread the costs of one-off expenses such as white goods and furniture, moving back to the community and unexpected crises. The government recently reviewed the role and design of the Social Fund in an attempt to better maximise its impact (DWP 2010) and the 2011 Welfare Reform Bill proposes significant changes including the abolition of community care grants and crisis loans, to be replaced by 'locally-administered assistance'. The charity Family Action warns that localising the Social Fund could lead to a post code lottery of provision and leave families in crisis with nowhere to turn if existing funding is not maintained.<sup>5</sup> According to Barnardo's (2009) the government needs to do more to allow low income families quick access to small amounts of credit from the Social Fund. Barnardo's argues that this is precisely the sort of need that home credit or hire purchase arrangements are used to fill, and it is these smaller amounts that attract the highest interest rates in the sub-prime credit market. Barnardo's also argues that the government could do more to meet the needs of low income families by linking various sources of information and advice to families through the Social Fund scheme.

Another important source of government provision for low income families has been the DWP Growth Fund, financed through the Financial Inclusion Fund. The Growth Fund, which operated from 2006 to March 2011, was co-ordinated by the Department for Work and Pensions and aimed to improve access to lower-cost credit in deprived communities (see Table 11). A recent evaluation concluded that the scheme overwhelmingly met its objective of providing access to affordable credit in low income communities. The evidence also suggested that it was effective in reaching its target audience; eight in ten borrowers were from the two lowest income quintiles as Collard et al. (2010) report.

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<sup>5</sup><http://www.family-action.org.uk/standard.aspx?id=13753>

Consumer Focus was just one of many organisations that strongly recommended the continuation of the Growth Fund which came to an end in March 2011 (Burton 2010). Following on from the Growth Fund, the government has recently announced a further £73 million investment to continue the expansion and modernisation of credit unions and other community lenders over the next four years, including the development of credit services for people lacking access to affordable credit.<sup>6</sup>

**Table 11: The UK Social Fund and the UK Growth Fund**

**Social Fund:** the Social Fund currently provides interest free loans and grants to households in three ways: through Budgeting Loans, Crisis Loans and Community Care Grants. Budgeting Loans are available to claimants of Income Support or Income-Based Jobseekers Allowance who have been claiming for more than 26 weeks. Crisis Loans are available to any household in a position of extreme need. Community Grants are available to particularly vulnerable individuals meeting some restrictive conditions. Government spending on the social fund has increased steadily in recent years and net expenditure currently stands at £269.6 million for 2010/11; the latest breakdown shows £138.9m allocated to community care grants, £26m for budgeting loans and £104.7m given to crisis loans (DWP 2011). The government is currently reforming the Social Fund. It plans to abolish the discretionary Social fund, which provides crisis loans, community care grants and budgeting loans. Budgeting loans will be replaced with payments on account through the Universal Credit payment. Crisis loans and community care grants will cease, in order to be replaced with local provision.

**Growth Fund:** the lack of affordable credit for people on low incomes in deprived areas has been a source of concern for government and community-focussed organisations. The DWP Growth Fund was targeted at communities in Britain where there was evidence of a mismatch between the demand for and supply of affordable credit. Third sector (not-for-profit) lenders such as credit unions and community development finance institutions delivered the Growth Fund (affordable personal loans) service. Part of the aim was to disrupt the use of high-cost credit in these areas. Some 317,798 Growth Fund loans were made available between July 2006 and September 2010, with a total value of over £137 million. An additional 12,090 loans were made in October 2010. Analysis indicated that 79 per cent of recipients were in the two lowest income quintiles, while one in five (20 per cent) did not have a current or basic bank account (Collard *et al.* 2010). The Growth Fund ended in March 2011.

People living in Growth Fund catchment areas were recently surveyed for their views on access to affordable credit. The survey was commissioned by the Financial Inclusion Taskforce (2007) and the fieldwork was undertaken by GfK NOP (a market research company); 2,805 people were interviewed. The survey reported:

- 12 per cent identified a lack of access to affordable credit as a problem in their community

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<sup>6</sup><http://www.which.co.uk/news/2011/03/government-pledges-73m-credit-union-investment-246671/>

- 37 per cent viewed credit as occasionally necessary, and 10 per cent as a convenient way of buying things. 51 per cent of those questioned said that borrowing is never a good thing
- 60 per cent of people were managing to keep up with repayments without difficulty, six per cent experienced difficulty with repayments, however the figure rose to around one in five (17 per cent) of those when borrowing was greater than £500 of high-cost credit
- 50 per cent regarded home credit as high-cost, only two per cent saw it as low cost
- 21 per cent of respondents identified credit union loans as being low-cost.

Summing up, the Financial Inclusion Taskforce concludes that people on low incomes are generally more ambivalent about credit use than those on higher incomes. The Taskforce also notes that in many cases this attitude has not actually prevented people from using credit products. This suggests that many people in these areas are using credit as a necessity even though they would naturally prefer not to. The 2007 survey was intended as a baseline of credit use among people in deprived areas, against which future waves of the survey will be measured. It remains unclear whether the survey will be repeated, particularly as the Financial Inclusion Taskforce was disbanded at the end of March 2011.<sup>7</sup>

### **3.2.4 Summary, UK**

There is general agreement in the UK on the need for reform in the credit market and the government has been considering the options. There also appears to be a broad level of consensus among many experts and research organisation on what needs to be done and the way forward:

- better information for consumers, with clear fee structures
- improved choice of product and provider for consumers
- fair and responsible lending practices
- increased need for social banking and third sector lending.

When it comes to interest rate restrictions however, opinions diverge. There is, on the one hand, 500 organisations under the Better Banking campaign umbrella calling for:

- greater transparency from banks about the communities they do and don't serve
- an incentive structure to encourage banks to fully engage with people and businesses in all communities
- a cap on extortionate lending rates
- a commitment from banks to re-invest one per cent of their profits for social benefit.

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<sup>7</sup>The Financial Inclusion Taskforce was appointed by HM Treasury as an independent body to advise and to monitor and evaluate progress on its financial inclusion goals.



The New Economics Foundation (NEF) has reached similar conclusions, but it also notes that it is not only banks who should be compelled to disclose their lending patterns, but also sub-prime and third sector lenders as well (NEF 2009). It also proposes that the exact level of any cap, if introduced in the UK, needs to be investigated as there is a need to establish the real risk of default and for the cap to be set accordingly. It also urges the government to do more to abolish credit dependency by ensuring people have sufficient income to maintain an accepted standard of living.

On the other hand there is a counter view, held by many in the sub-prime credit industry, but also the OFT (which enforces consumer credit protection in the UK), some research centres and academics, and charity and voluntary sector organisations. They argue that interest rate caps are not warranted in the UK; they believe such measures would have a negative impact on the UK sub-prime credit market which would likely go into a decline, adversely affecting low income families as the supply of credit providers and products dries up.

### **3.3 France**

France has a strong economy with a GDP per capita of US\$33,090 and a population of 61.8 million, figures which are comparable with the UK (see Appendix 1). The total value of the consumer credit market in France was eight per cent of GDP in 2008 or €155.7 billion (Table 5). Household debt in France is relatively low for a major economy, with a debt to income ratio at 102.3 per cent of nominal disposable income in 2008 and 106.6 in 2009, of which mortgages account for 76.6 per cent of nominal disposable income in 2008 (see Table 7).

#### **3.3.1 Financial inclusion in France**

Financial exclusion, as conventionally measured by the European Commission (2008), is low in France with just two per cent of the population experiencing exclusion in 2003 (shown in Table 1). Access to banking in France is near universal; four per cent of the population have no transaction bank account, one per cent of the population are marginally banked and three per cent are completely unbanked (shown in Table 3). Jauneau and Olm (2010) report that about a third (31 per cent) of those living below 60 per cent of the median income (at-risk of poverty) in France have a loan, which suggests that access to credit may be a challenge for some low income families as Gloukoviezoff (2011) argues.

#### **3.3.2 Credit market and regulation in France**

The consumer credit market in France is mainly characterised by the major retail banks (e.g. BNP Paribas), and consumer credit providers (e.g. supermarkets, car dealers). The value of credit advanced to consumers in France totalled just over €155.7 billion in 2008, equivalent to about 8 per cent of GDP (Table 5). In contrast to the UK, the French sub-prime market remains underdeveloped however, with evidence suggesting that low income families may

find it difficult to access credit. There is little evidence to suggest illegal lending markets operating in France although this may, at least in part, reflect a lack of research intelligence (Buckland 2009). Historically, there has been a strong co-operative banking tradition in France but as Gloukoviezoff (2010) reports, this sector has been in steady decline over the years.

In France there is a strong regulatory framework with interest rate restrictions. The French system places strict rules on the banks; the components of APR are tightly specified by the Banque de France which only allows limited flexibility when setting interest rates for loans and other credit products (Policis 2004a; Jauneau and Olm 2010). The current usury framework dates back to 1966, with both usury and consumer protection frameworks subsumed in the Code de la Consommation. Usury rates are set every quarter at one third above the average market rates as assessed by the Banque de France. In the past there were different rates for personal instalment loans, revolving credit loans and overdrafts. However, this was recently reformed so that the cap now varies depending on the amount borrowed. When the amount borrowed is below 1,524 Euros, the ceiling for APR is 21.15 per cent (July 2010), if the amount is above this and there are no fixed payments, then the rate is 19.27 per cent and the rate is 8.61 per cent if there is a monthly payment plan in place. It is worth noting that these rates are lower than current caps on credit union loans in the UK at 26.8 per cent APR.

Quality access to consumer credit has been a longstanding priority for the French government. Laws, such as the Scrivener law from 1978, promote quality of information, meaning borrowers should be better informed, so much so that most of the conditions of the European Consumer Credit Directive (CCD) were already in place in France when the European Council adopted this in May 2008.

### ***3.3.3 Credit for low income consumers and the social banking sector in France***

There are a number of loan programmes for low income consumers in France, and Gloukoviezoff (2007) provides a general overview. The main one appears to be the Fonds de cohésion sociale (Social Cohesion Fund), a government programme of loan guarantees which began in January 2005 (Ministère de l'emploi de la cohésion sociale et du logement 2006). The loan guarantees are meant to encourage co-operative and postal banks and specialized financial institutions (including some credit card issuers) to provide credit to people who otherwise lack access to mainstream bank credit. The loans provided are in the region of €300 to €4,000 (and up to €12,000 for emergencies and accidents), and are repaid over a maximum period of 48 months (although they may be extended to 60 months).

The Banque de France reports that, as at 31 December 2009, 11,529 personal loans had been guaranteed by the Social Cohesion Fund, which were delivered through a range of partner organisations. The average loan amount was €2,263. A European Commission study indicates that the APR for these loans is usually between four and eight per cent;

loans are mainly extended for expenses such as buying a car, paying for training, and unexpected expenses (European Commission, 2008).

The *Crédit Solidaire* (Solidarity Credit) is offered by the *Caisse Régionale de Crédit Agricole du Nord-est* (Beaujouan 2006). It is a consumer micro-loan that is available to vulnerable people in North-eastern France. The loan is available to people who face acute financial challenges due to some unforeseen event such as family illness or the loss of a job. *Crédit Mutuel* (social microcredit) and *Secours Catholique* (Caritas France) have also developed loans to support victims and families involved in unforeseen events.

As with other European countries, France has a system of public pawnshops (*Prêt sur gage*) with roots in the 17<sup>th</sup> century *Crédit municipal*; many offer mini prêt or micro-credit. There are approximately 15 public pawnshops across France including, Paris, Lyon, Marseille, Bordeaux, Nantes, Toulouse, and Dijon, interest charges for loans are generally around 10 per cent APR (Gloukoviezoff 2007).

Gloukoviezoff notes that financial cooperatives once played an important role in French society which led them to become the main banks of today. In more recent times there has been a decline; the new innovative schemes and pilots providing small-sum loans for low income families facing financial difficulties are mainly on a small scale (2010).

‘Co-operative banks are still able to be innovative in relation to financial inclusion through the provision of appropriate services which meet the needs of people with low income. However these services remain limited. They reach very few customers and they have almost no impact on the great majority of people facing banking difficulties even when they are customers of these co-operative banks (2010: 15)’.

### **3.3.4 Summary, France**

Experts who have examined the French system conclude that access to credit remains a problem for low income households (e.g. Policis 2004a). They pinpoint the underdeveloped sub-prime market, which they argue is a result of interest rate caps imposed on the financial sector. It has been argued that the research evidence from France suggests that high risk borrowers often use credit vehicles designed for lower risk borrowers, the inappropriate nature of which causes problems. Accordingly, this pushes up the cost of consumer credit meaning minimum loan values are set high and thus out of scale to the funds that low-income households require and are able to service. High-risk borrowers can find themselves unable to pay down balances and thus become trapped in a cycle of debt. The investigative interviews conducted for this study highlighted some of these same issues (see Section 5 for details).

Others, notably campaigners for interest rate restrictions, reject this picture (e.g. NEF 2009). Gloukoviezoff (2011) acknowledges the absence of a sub-prime market due to the interest

rate cap, but also reports that no scientific study has been carried out in France analysing the impact of interest rate caps on financial difficulties. So, on the downside there are lower levels of access to credit in France and this can make life difficult for more high risk borrowers on a low income, particularly compared to the UK. On the upside, households overall seem to experience less debt (Table 7) and lower levels of financial difficulties (although we do not have separate figures for low-income households). There is little evidence that suggests higher levels of financial difficulties specifically due to interest rate caps. In the French system we may conclude that increased access to credit is not seen as positive if the quality of this access is poor.

### **3.4 Germany**

Germany has a strong economy with a GDP per capita which is similar to the UK at US\$35,432 (see Appendix 1). The population of Germany is 82.772 million. The value of credit advanced to consumers in Germany totalled just over €224 billion in 2008, equivalent to about 9 per cent of GDP (Table 5). Consumer credit per capita in Germany amounted to €2,700 in 2008, a much lower level than the UK (OFT 2009c). Household debt in Germany is relatively low and comparable with France, with a debt to income ratio at 99 per cent of disposable income in 2009, of which mortgages account for 67 per cent of disposable income (Table 7).

#### **3.4.1 Financial inclusion in Germany**

Access to banking is near universal in Germany. The European Commission (2008a) found only three per cent of the population were financially excluded in 2003 (Table 1); some seven per cent had no transaction bank account, two per cent were marginally banked and five per cent completely unbanked (Table 3).

#### **3.4.2 Credit market and regulation in Germany**

The value of credit advanced to consumers in Germany totalled just over €224.1 billion in 2008, equivalent to about nine per cent of GDP (Table 5). Germany has a long tradition of self-regulation of financial services. Legislative protection of private borrowers was achieved in Germany in 1991 with the 1990 Consumer Credit Act (Verbraucher-Kreditgesetz), later amended in 1993. The Act has a very broad coverage and basically protects all private borrowers (who have not taken loans for investment, commercial or professional purpose). The German Consumer Credit Act does not contain any limitation on price elements and no limit on interest rates. The only safeguard is the general clause of the German Civil Code 138 declaring unconscionable contracts void. However, the Act has been interpreted by the Courts, so that a credit agreement is 'extortionate' and thus subject to prosecution if the interest rate agreed upon exceeds twice the average lending rate for a given loan type (published every month by the Bundesbank). The major legally binding guidelines relate to two ceilings: first, the maximum interest rates on consumer credit (covering consumer loans

and overdrafts) and a second legally binding guideline relates to the default interest rate. The latter is set lower than most rates as an incentive for lenders to avoid default.

The lending regime in Germany is underpinned by a comprehensive national credit reference database with exceptionally wide coverage. The main organization responsible for maintaining credit history information is Schufa (Schutzgemeinschaft für allgemeine Kreditsicherung), an organisation of credit granting organizations in Germany. Schufa is not the only credit reference institution in Germany, but it is the largest (in terms of staff, collected information, market share for example) and the most used (OFT 2009a).

### ***3.4.3 Credit for low income consumers and social banking sector in Germany***

Mainstream commercial profit-oriented providers and socially orientated co-operative banks in Germany have developed simple, low cost transaction bank accounts to meet the needs of people on low and unstable incomes (European Commission 2008). Examples of co-operative banks operating throughout Germany include DZ Bank (Deutsche Zentralgenossenschaftsbank), Volksbank and Raiffeisenbank. Salaries tend to be paid directly into bank accounts and a range of financial products (such as overdrafts) are made available automatically on the basis of income.

In terms of credit provision, Sparkassen, a national network of savings banks, is a primary source of credit for those on low incomes. It has minimum loan values set at €2,500 in 2010 or in some cases the value may be extended to €5,000, and applicants usually need at least six months employment on a permanent contract.<sup>8</sup> The OFT (2009a), in its review of the German credit system, observed that the Sparkassen, while still the most important source of credit for those on low incomes, was increasingly focusing on lending to people in work and those with a minimum history of contracted permanent employment. The OFT also noted that overdraft facilities for German bank customers on low incomes are increasingly being limited, while the minimum loan values set by Sparkassen effectively exclude those on the lowest incomes.

According to the OFT inquiry, the sub-prime lending sector in Germany remains rather limited, with a very small number of lenders operating in the market (OFT 2009a). Research carried out for the European Commission indicated that the options available to consumers turned down for credit by the banks were to borrow from a pawnbroker or use a private credit broker; concerns have been expressed in Germany about how some credit brokers operate (European Commission, 2008).

A survey by Datamonitor (2007) uncovered a general lack of awareness about the sub-prime sector among the traditional German banks and lenders, all of which presents issues for consumers who are refused credit from the mainstream providers. Certainly compared to

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<sup>8</sup>[www.sparkasse.de/index.html](http://www.sparkasse.de/index.html)

the UK, Germany does not have a distinct sub-prime sector leading some to conclude that the German credit system excludes low-income families as a result (e.g. Policis 2004a, 2004b). In a review of the German credit market, which was conducted for the then UK Department of Trade and Industry (DTI, which is now BIS), it was reported that lenders in Germany have responded to interest rate ceilings by raising access hurdles to high risk borrowers (Policis, 2004a). The report suggested that the German system provides a good example of how an interest rate ceiling can result in highly risk averse lending policies, particularly when combined with disincentives to default. The same report notes that credit scoring thresholds are set at levels likely to exclude higher risk groups.

More broadly, Policis suggests that there is a consistency of demand for credit in major economies like Germany but the issue for low-income consumers in the German context is the lack of credit availability. They argue that low credit use among the poorest German households is more a function of lack of supply rather than any cultural resistance to borrowing or lower incidence of need. In practice this means that families in Germany who feel they are unable to get credit have few means of managing cash flow crises or little chance of acquiring items that they need but are unable to afford.

#### **3.4.4 Summary, Germany**

The distinguishing principles of German legislation are self-regulation, transparency and avoidance of default. Germany provides a case study which throws light on the effects of regulation and, in particular, interest rate restrictions and disincentives to default on the shape and development of the mainstream and the sub-prime consumer credit sectors (OFT 2009a). According to the OFT, most people excluded from credit either do without credit or may consider informal or illegal lending (OFT 2009c). It is difficult to get clear measures of this but illegal lending does occur in Germany; principally in the fragmented credit broker sector which is seen as a last resort for subprime borrowers with negative credit reports (OFT 2009a).

### **3.5 Australia**

Australia has a strong economy with a GDP per capita of US\$38,637; the population, at 21 million, is a third of that in the UK and France and a quarter of Germany's (see Appendix 1). The financial sector is one of the largest contributors to GDP in Australia. The overall picture of household indebtedness is comparable to the UK, at 173 per cent of annual disposable income in 2005 (OECD 2006). Australia has a parliamentary system of democracy with a federal system of government. The federal government is the national government with certain legislative powers and responsibilities under the Constitution; remaining responsibilities are allocated to the States and two territories (Australian Capital Territory, New South Wales, Northern Territory, Queensland, South Australia, Tasmania, Victoria, Western Australia). Each State has its own constitution, so that Australia has seven sovereign Parliaments, none of which can encroach on the functions of any other. A basic

understanding of the federal system of government is necessary for understanding the regulation of the credit market.

### **3.5.1 *Financial inclusion in Australia***

According to some charities and not-for-profit organisations, such as the influential Brotherhood of St Laurence, Australia lacks a vision for financial inclusion in government policy (Arashiro 2010). There is also a lack of good robust comparative data on levels of financial exclusion. One recent national survey found that 97 per cent of people had an ordinary everyday banking account, which suggests that financial exclusion may be low in Australia, at least according to this headline indicator (ANZ and Social Research Centre 2008).

### **3.5.2 *Credit market and regulation in Australia***

The use of consumer credit has grown rapidly in Australia over the past 20 years. Australia now has one of the largest credit markets in the world. The exact size of the short term lending market in Australia has not been quantified with any degree of precision in recent years. However, a recent estimate by the National Financial Service Federation (NFSF), in 2008, reported payday lending and micro loans to be worth approximately \$500 million per annum in Australia (National Financial Service Federation 2008). It is likely that there has been a significant increase in the size of the market since the NFSF estimate in 2008.

Like the UK, Australia has maintained a fairly liberal credit market, certainly compared with the other more regulated markets in France and Germany. Australian consumers have significant levels of household debt, and like the UK there has been a major long-standing debate over responsible lending and the appropriate roles and responsibilities of government (at State and Federal levels) in regulating this market (e.g. Wilson 2002; Government of South Australia 2006; Gillam 2010).

Australia's various state and territory governments have traditionally regulated high-cost short-term lending as part of their general regulatory responsibility for consumer credit. In 1996 the Uniform Consumer Credit Code (UCCC) came into legal effect in most Australian states and territories. The agreement had been reached by state and territory governments in 1993 under the Australian Uniform Credit Laws Agreement; Tasmania and Western Australia, however, both chose to retain a degree of legislative independence.

States and territories agreed a co-operative scheme for uniform regulation of consumer credit. However, under the agreement, certain matters were reserved for individual states and territories providing for variation on matters not covered by the UCCC regime. These 'non-uniform matters' included the licensing and registration of credit providers and also the fixing of maximum interest rates or caps. This legislation resulted in a 'patchwork' of regulation for the industry at the state level (see Table 12).





**Table 12: State and territory regulation of high-cost credit**

State or Territory	Approach
Australian Capital Territory	48 per cent APR comprehensive cap
New South Wales	48 per cent APR comprehensive cap
Northern Territory	No regulation beyond UCCC
Queensland	48 per cent APR comprehensive cap
South Australia	No regulation beyond UCCC
Tasmania	No regulation beyond UCCC
Victoria	48 per cent APR interest rate cap
Western Australia	Licensing required but no cap

Source: Gillam (2010: 17).

This was the regulatory framework that the UK's OFT found and reported on in late 2009 (OFT 2009b). However, the situation in Australia has changed dramatically since this time. Clearly the UCCC did not achieve the uniformity of credit regulation which had been hoped and the Federal Government set out plans for further reform (Commonwealth of Australia 2008). In July 2010 the Federal Government assumed responsibility for the regulation of consumer credit in Australia (Commonwealth of Australia 2010). The National Consumer Credit Protection (NCCP) Act and Reform Package provides a new and uniform national law for consumer credit in Australia, including provision relating to the high-cost of short-term loans.

Phase One of the reform package included:

- a comprehensive licensing regime for all providers of consumer credit and services
- responsible lending conduct requirements on licensees (i.e. lenders should not provide credit products and services that are unsuitable for the consumer's needs and that the consumer does not have the capacity to repay)
- improved sanctions and enhanced enforcement powers for the regulator (i.e. the Australian Securities and Investments Commission (ASIC))
- expanded consumer protection through court arrangements, remedies for consumers and penalties for misconduct
- an expanded scope for the National Credit Code to include credit provided to purchase, renovate, improve or refinance a residential investment property
- provisions to stop predatory lenders from exploitative practices such as using household items as security for cash loans
- a single national licensing regime and consistent requirements across Australia for lenders and brokers.<sup>9,10</sup>

<sup>9</sup>[www.treasury.gov.au/consumercredit/content/legislation.asp](http://www.treasury.gov.au/consumercredit/content/legislation.asp)

<sup>10</sup><http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/077.htm&pageID=003&min=ceb a&Year=&DocType=>

The new responsible lending obligations require lenders to obtain a Money Lenders licence (already the case in Western Australia) and to join an approved external dispute resolution scheme (Australian Securities and Investments Commission (ASIC)). Lenders are also required to make an assessment of whether the loan product they are offering is suitable for the consumer. The issue of interest rate caps was hotly contested during the Phase One consultation process (Commonwealth of Australia 2010). Consequently the Federal Government agreed that jurisdictions with interest rate caps in place would retain them, those without caps would not introduce them, and the issue of interest rate caps would be considered during the course of 2011 (Phase Two). Legislation for Phase Two is still being developed and is expected to be in place by mid-2012.

Academics and third sector organisations have voiced concerns. The Consumer Action Law Centre, an independent, not-for-profit organisation with a long-standing interest in consumer credit and debt issues, has welcomed the reforms but warns they may not have a significant effect on the industry (Gillam 2010). The Centre is campaigning for a comprehensive interest rate cap; it argues that the present case by case approach to regulation (i.e. each case being litigated separately to decide whether or not the interest rate is extortionate) is costly and labour intensive. In contrast, researchers at the University of Queensland have been more critical of the broader system, arguing that for-profit providers have filled the gap left by inadequate public services in Australia and the historical withdrawal of mainstream credit services from low-income families (Marston and Shevellar 2010).

### ***3.5.3 Credit for low income consumers and the social banking sector in Australia***

Australia appears to have a growing and innovative social lending sector, aided by Federal Government with industry support and backing (further details are given in Section 5.4). Australians who are excluded from mainstream banks and services are being assisted to access fair and appropriate financial products and loans. Certainly Australia appears to be one of the leading economies from which to learn important lessons about the potential and development of social banking.

The social lending sector has benefited from the hard work and national campaigning of the leading charities such as the Brotherhood of St Laurence, and the Good Shepherd Youth and Family Service and Community Co-operatives working in partnership with government and industry, including some of Australia's leading banks. The social banking cause in Australia has attracted support and funding from the Federal Government (Macklin 2009) and from the big banks, NAB and ANZ (see Table 13). Australia perhaps offers a case in point for learning lessons on how to engage business and foster a culture of the 'Big Society', with access to affordable credit for some of the most vulnerable people in society. Corporate sectors have partnered innovative microfinance programs to assist financially disadvantaged groups, such as the first Australian matched savings program Saver Plus (initiated by the

Brotherhood of St Laurence/ANZ), microloans such as Step Up (Good Shepherd Youth and Family Service/NAB) and Progress Loans (Brotherhood of St Laurence/ANZ), and the no-interest loans scheme (NILS), introduced by the Good Shepherd Youth and Family Service.

On 17 February 2011, the Federal Government announced major new funding for the social banking sector (Macklin 2011). The Government announced AUD\$6.27 million of support, as part of a pilot program, for five Community Development Finance Institutions (CDFIs) that have all demonstrated a commitment to supporting vulnerable Australians to get access to financial services. One of the CDFIs, Foresters Community Finance (2009), has set out Foundational Principles for CDFIs in Australia (see Appendix 2).

### **3.5.4 Summary, Australia**

Australia is comparable to the UK in many ways; the financial sector provides a significant contribution to GDP and the high-cost credit sector is a valuable sector within the economy. Importantly this sector helps to provide low income families with access to credit although there has been growing concern about the quality of access, and provision. Increasingly, questions of affordability of credit and interest rate caps have often arisen in policy debates. Stories of low income families being trapped in a spiral of debt often make the headlines, as they do in the UK. The Federal Government has been reluctant to impose interest rate restrictions on the credit market, however in recent years the Federal Government has found itself grappling with the issue of affordable credit and market regulation. There is growing pressure for the Federal Government in Australia to take tougher action on high-cost short term lending practices in Australia and the government is currently considering national interest rate caps.

Interestingly, Australia appears to have fostered a growing social banking sector in recent years with the support of the Federal Government, industry, including some of the major Australian banks (ANZ, NAB), and various charities who have been effective in their campaigning for affordable credit provision to help low income families in Australia to make ends meet. With Big Society initiatives planned in the UK, emerging lessons from Australia on the provision of affordable credit and financial inclusion more generally will be valuable for UK policy makers interested in tackling financial exclusion and credit exclusion in particular.

## **4 Review of recent opinion surveys and stakeholder consultations**

### **4.1 Introduction**

Numerous surveys and stakeholder consultations on issues relating to financial inclusion and affordable credit for low income consumers have already been conducted in EU countries and indeed across the EU. The European Commission consultation on basic bank accounts, for example, touched on issues relating to financial inclusion and affordable credit for low income consumers (European Commission 2009). The EU invited responses from key experts across the EU within seven main categories (public agencies and authorities, consumers/users, financial services industry, trade unions, civil society organisations, academics/think-tanks and individuals). The European Commission has recently consulted on interest rate restrictions; a recent report by Institut für Finanzdienstleistungen (IFF) highlighted the different attitudes of many member countries to interest rate restrictions (iff/ZEW 2010). In this section we review the findings from these recent studies, particularly in relation to corresponding views about basic bank accounts and credit, and interest rate restrictions and policies on financial inclusion from major stakeholders in the UK, France and Germany, along with organisations taking a pan-European view.

The existing body of work also informed our own guide for investigative interviews with key stakeholders in the UK, France, Germany and in Australia, which aimed to add to this body of knowledge. The standard interview schedule and the organisations consulted for the study are given in Appendix 3. The main findings from the interviews are reported in Section 5.

#### **4.1.1 *Financial exclusion and inclusion***

Most stakeholders seem to agree that the role of alternative commercial and not-for-profit financial service providers in addressing financial exclusion can be enhanced (European Commission 2009). Lack of appropriate information about products, rather than availability, often exacerbates financial exclusion. Stakeholders in the consumer groups felt that banks can make profits, while at the same time being socially obligated to contribute to financial inclusion. Many experts felt that access to a basic bank account was a key goal; while access to credit was a second order priority for financial inclusion. But this may relate to the extent to which the lack of a bank account is an issue for the EU countries a whole; this may be less of a priority in UK, Germany and France where banking exclusion is relatively low in comparison to many other EU countries. The following selected quotes capture the positions and are used judiciously to illustrate:

- ‘EAPB believes that **financial inclusion should be addressed at the national level as the situation is very different in each Member State with regard to different banking cultures, economic and social conditions, and the welfare system**. Moreover, the use of transaction banking services is different in each Member State due to cultural habits. Financial inclusion is closely linked with social inclusion. Co-operative banks, as socially committed banks, are continuously at the forefront in the fight against financial exclusion. The notion of social inclusion is enshrined in the very core of their co-operative governance model’ (European Association of Public Banks (EAPB), Industry group, EU Level).
- ‘**In promoting financial inclusion, we believe that the best role the EU can play is in raising awareness across all member states**, sharing ideas and best practice, as the different financial customs across the 27 member states and the subsidiarity principle suggest that this is best approached at member state level’ (British Banker’s Association, Industry Group, UK).

#### **4.1.2 Basic bank accounts and access to credit**

All stakeholders welcomed the European Commission’s initiative on basic banking as an important element of promoting financial inclusion (European Commission 2009). Many stakeholders however saw that financial exclusion extended beyond basic banking services and included other financial services, such as credit and savings. Some of the stakeholders argued that credit unions and social banking should have an enhanced role in addressing financial exclusion mentioned. The following selected quotes capture the positions and are used judiciously to illustrate:

- ‘**the principles of responsible lending and borrowing are essential features of the well-developed consumer credit market**’ (The Finance & Leasing Association (FLA), Industry Group, UK).
- ‘**Typical examples of financial exclusion include a lack of access to an appropriate bank account, savings products, insurance or affordable credit**, or a lack of ability to choose and use the most appropriate product features’ (Financial Services Consumer Panel, Consumer, UK).
- ‘First of all we would like to clarify that granting a bank account is not a social obligation but should be a general public service. Second, the individual bank is allowed to raise fees in return for services. Third, **the bank can decide if granting credit with the account or not**’ (Verbraucherzentrale Bundesverband, Consumer, Germany).
- ‘Alternative commercial and not for profit financial services providers, such as **credit unions, should have an enhanced role in addressing financial exclusion**, as they are often best placed to deliver services to financially excluded people’ (Leeds City Council, Public Authority, UK).
- ‘The Financial Inclusion Taskforce, which recently reported to the UK government on bank actions to support affordable credit, **expressed a desire to see more competition**

**in this market and encouraged other banks to consider making their own products available through credit unions'** (The Financial Inclusion Taskforce Public Authority, UK).

- **'Credit unions, CDFIs and the third sector all have a role to play in addressing financial exclusion**, by offering suitable accounts and supporting people in taking out commercial accounts' (Age Concern and Help the Aged, Civil Society Organisations, UK).

Stakeholders in the consumer groups felt that banks can make profits, while at the same time being socially obligated to contribute to financial inclusion. Public authority groups, academics, think-tanks and civil society organisations took a similar view. A trade union group thought that universal access and affordable credit for all was a necessity.

#### **4.1.3 Interest rate restrictions**

A 2009 study by Institut für Finanzdienstleistungen (IFF) aimed to provide the European Commission with comprehensive information on the types of interest rate restrictions (IRR) that exist in the EU Member States, as well looking at their impact on both credit markets and consumers (iff/ZEW 2010). The study comprised a review of the literature and a consultation exercise with national providers of both secured and unsecured consumer credit. The list of contacted providers included commercial banks (mainstream), non-bank mortgage lenders, non-bank point-of-sale lenders, credit card companies, moneylenders such as payday lenders and door-to-door lenders, and pawnbrokers.

There was a poor response to the research consultation, however. From a total of 137 credit providers contacted there were only 18 responses and three submitted written comments. There were 31 explicit refusals and no reply from the rest. Despite these limitations, many of the submissions and comments received are relevant to this project, particularly those around the effects of interest rate restrictions, and reflect a range of positions and views held by credit providers, government officials and consumer organisations in the UK, France and Germany.

In particular, the report highlighted the different attitudes of many member countries to interest rate restrictions. In some Member States strict interest rate caps were defended on the basis that credit at a high price may increase consumer insolvency and reflected the malfunctioning of markets, especially for small amounts of credit. In others, the absence of such regulations is justified primarily on the basis that caps would reduce access to credit, especially for people with moderate means.

Perhaps unsurprisingly, many credit providers in the UK, France and Germany were not in favour of interest rate restrictions. Many thought that interest rate restrictions result in a reduction in supply and therefore serve to limit consumer choice and could lead more consumers into debt or force them to borrow from unscrupulous lenders. The following selected quotes capture the positions and are used judiciously to illustrate:

- **'The most likely impact of an IRR would be a reduction in supply and therefore consumer choice'** (Commercial bank, UK).
- 'We believe that interest rate caps do not work and could lead more consumers into debt or force them to borrow from unscrupulous lenders (Commercial bank, UK).
- 'Access to credit is determined based on the customer's and lender's risk profile, i.e. ability to pay and appetite to lend. **We believe that charging interest rates based on risk is a feature of prudential lending. The transparency of interest rate and charge structures offered by lenders and the ability of debtors to switch from lender to lender is a far better control on any possibility of unacceptable behaviour by lenders than IRR'** (Commercial bank, UK).
- 'Most groups realise that introducing a rate cap would cause companies to be more selective and offer longer term products which would make credit difficult to obtain for anyone wanting a short term product to help them with an unforeseen short term cash flow problem. **A rate cap would reduce the choice customers have for short term products'** (Home credit provider, UK).
- **'The very real risk is that a price cap would cause this (illegal lending) to increase.** The research by POLICIS for the UK Government said that France and Germany (with price caps) had higher levels of illegal lending than the UK' (Home credit provider, UK).
- **'The result of too much regulation could result in lenders pulling out of the market** and increasing the market share of illegal moneylenders' (Home credit provider, UK).
- 'We are open to the argument but remain to be convinced that a rate cap would, on balance, benefit to UK consumers' (Consumer Organisation, UK).
- 'It has not been deemed necessary to regulate interest rates. Rate restrictions would not enhance the UK's existing legislation but would potentially **restrict the market, constrain competition and be to the detriment of the consumer'** (Provider Association, UK).
- **'There are no consumer benefits,** only detriment, caused by regulated interest rates' (Provider Association, UK).
- '(Have) concerns that introducing ceilings on **interest rates could lead to a decrease in access to legitimate sources of credit and an increase in use of unlicensed sources of credit'** (Government Official, UK).'
- **'IRR exclude consumers with a lower creditworthiness from obtaining credit.** This is because banks are not able to cover the actual costs of credit for those consumers due to IRR' (Provider Association, Germany).
- **'A main objection is the general attitude that prices are to be influenced by the market,** not the law. Rules and court rules on fees may yet always refer to inadequate and one-sided influence on pricing as market rules do not or do not adequately apply' (Consumer Organisation, Germany).
- 'We are rather for the removal of regulation on the rate' (Consumer Organisation, France).
- 'The credit market is much more competitive now than it was when the legal usury rate was introduced. Still, the financial crisis led the French government to consider that

interest rate restrictions are an effective protection against excessive risk-exposure by money lenders and borrowers. **Indeed, sub-primes and near-primes do not exist in France. All in all, consumers have benefited from the interest rate ceilings.** On the one hand, this ensures that money-lenders will not use their market power to enforce abusive interest rates. On the other hand, it does prevent the riskiest consumers from accessing the credit market' (Government Official, France).

- The European Commission has recently been consulting on interest rate restrictions. The Commission found that interest rate restrictions were supported by consumer interest groups and were opposed by industry. At the state level the picture was more mixed with some countries favouring them and others opposing them. The Commission notes that the findings, as well as the comments received during this consultation, will be taken into account by the Commission services when developing any future position on interest rate restrictions.<sup>11</sup>

## 4.2 Summary and conclusions

This review of recent consultation responses highlights a number of areas of consensus, but also a degree of divergence in stakeholder's views about consumer credit regulation.

- Most stakeholders seem to agree that the role of alternative commercial and not-for-profit financial service providers in addressing financial exclusion can be enhanced.
- Lack of information about products, rather than availability, often exacerbates financial exclusion.
- Stakeholders in the consumer groups felt that banks can make profits, while at the same time being socially obligated to contribute to financial inclusion.
- Many experts felt that access to a basic bank account was key, while access to credit was a second order priority for financial inclusion. But this may relate to the extent to which the lack of a bank account is an issue for the EU countries a whole; this is less of a priority in UK, Germany and France where banking exclusion is relatively low in comparison.
- Perhaps unsurprisingly, credit cards companies, pawnbrokers and home credit providers were not in favour of interest rate restrictions. Most favoured self regulation by industry, and the strengthening of voluntary codes of conduct but many consumer groups felt that voluntary codes were ineffective.
- The forthcoming European Commission report, which will be available on the Commission's website, will provide new, up-to-date stakeholder opinions on interest rate restrictions.

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<sup>11</sup> [http://ec.europa.eu/internal\\_market/consultations/2011/interest\\_rate\\_restrictions\\_en.htm](http://ec.europa.eu/internal_market/consultations/2011/interest_rate_restrictions_en.htm)



## 5 Investigative interviews with stakeholders

This section draws upon eight telephone interviews conducted with the financial services industry, public authorities, consumer and civil society organisations, academics and think-tanks within our reference countries. These findings are intended to give an indication of the contemporary issues and debates in each of these countries; a comprehensive exploration of stakeholder views was outside the scope of this project.

It is worth noting that, particularly in France, respondents considered the problems of credit use among low income people to be poorly researched. In Australia, while there has been research in this area, the main sources of evidence concerning the impact of the introduction of rate caps seemed to come from consumer debt advice services and industry information.

### 5.1 Problems and issues around credit use

Two main issues were raised across the three countries:

- The high cost of commercial credit for people on low incomes, in the form of headline interest rates, and
- The appropriateness of credit products for people on low incomes, in particular the risk of borrowers getting into a cycle of ‘never-ending’ credit use as a result of using revolving credit or rollover loans.

In the **UK**, there are felt to be limited options for people on low incomes to access small-sum short term credit, and the options they have are often high cost. People who are better off tend to use credit cards for much the same purpose. UK respondents highlighted the need to distinguish between different types of lenders in the high-cost credit market, as they serve different markets and operate in different ways. A distinction was drawn, for example, between the younger working payday loan borrowers and home credit users who tend to be low earners or in receipt of state benefits as their main source of income. Credit linked to the purchase of goods (e.g. BrightHouse) is a different credit model again, with different issues for low-income borrowers.

In **France** (and Belgium) the cost of credit was not regarded as a major issue (or policy concern), because of the existence of the long-established interest rate caps described in Section 3, which had inhibited the growth of a sub-prime credit market. However, respondents noted that the risk assessment processes used by lenders (such as banks) excluded low-income borrowers, who in turn had few options for obtaining small-sum loans. As a result, there has been a growth in the use of revolving credit (such as credit cards) by people on low incomes to meet the need for small-sum credit.

While the headline cost of revolving credit is not a big issue in **France** and Belgium, respondents raised concerns about people on low incomes struggling to keep up with their payments on revolving credit, resulting in penalty charges. Another concern was that credit limits were often too high for the needs of low-income borrowers, resulting in a greater risk of over-indebtedness.

Consumer organisations in **Australia** drew a distinction between ‘productive’ credit that is used for purposes such as education and training or white goods, and credit that is used for consumption. Put simply, they encouraged the former and wanted to see a regulatory clamp-down in relation to the latter, in the form of a national comprehensive interest rate cap of 48% (currently being debated, as outlined in Section 3). They viewed high-cost short-term loans (such as payday loans) to be detrimental to consumers, because of the risk of borrowers getting into a cycle of debt through rollover loans. In this respect, they considered these types of loans to be more akin to revolving credit than one-off loans.

In both the **UK** and **Australia**, respondents felt strongly that affordable credit should not be regarded as a means to alleviate problems of poverty, which required a completely different policy response from governments. For this reason, respondents in Australia did not believe that social lenders should lend for recurrent everyday needs such as utility bills (see below).

## **5.2 Addressing consumer credit issues**

Respondents mentioned a range of different ways that these issues could be addressed (other than interest rate restrictions, which are discussed below). These included exploring ways of improving credit risk assessment to reduce the cost of credit to **UK** low-income borrowers. In **France**, a public register of all credit commitments (not just default data) is to be introduced, with the aim of stimulating competition and through greater data sharing between lenders. One respondent mentioned the work of some Spanish savings banks to develop knowledge and understanding of how best to provide financial services (including credit) to Latin American migrant communities.

In **France** (and Belgium), there are currently proposals under discussion that everyone who uses revolving credit should be required periodically to clear their credit balance completely (for example after three or five years depending on the balance), to avoid the problem of ‘never-ending’ credit. The details of this proposal have yet to be agreed.

The need for good advice and guidance for consumers was mentioned by respondents in the **UK** and **Australia**, to encourage borrowers to shop around and to consider alternatives to borrowing. The possible development of a low credit-limit credit card with reasonable charges was also mentioned by respondents from the UK and Australia.

### 5.3 Interest rate restrictions

As we saw in Section 3, in **France** (and Belgium) the credit market is already highly regulated, with long-established caps on interest rates. Respondents highlighted the difficulty of drawing comparisons between this type of credit environment and the very different credit market that exists in the **UK**, and warned against a ‘copy and paste’ approach to consumer credit regulation. Respondents noted that in **France** (and Belgium), the idea of removing the cap on interest rates would be considered morally and culturally unacceptable among the general public.

Respondents noted that one of the impacts of interest rate caps in **France** (and Belgium) had undoubtedly been to reduce access to credit, by regulating the amount of risk that lenders could take. They felt strongly that this reduction in credit access had to be considered in the context of levels of public assistance (i.e. social welfare payments), public services (such as widespread access to free education and health services) and wage levels. So in France, which has relatively high levels of public service provision and public assistance as well as a higher national minimum wage rate, access to credit may be less of an issue for people on low incomes than in the UK, where levels of public assistance are lower (see Appendix 1).

Among **UK** respondents, the key concern about the possible introduction of an interest rate cap was the potential detrimental impact on low-income borrowers, who they feared would face greater credit exclusion than already existed. This concern was heightened by the proposed changes to the discretionary Social Fund, which could further limit access to loans and grants for people on low incomes. They questioned how an interest rate cap would work in practice, for example in relation to credit linked to the sale of goods (would price regulation have to be introduced for these goods?). For one respondent, the wider question was how to ensure effective credit regulation and a properly-functioning competition authority, with a greater focus on specific areas of consumer detriment rather than a narrow debate on interest rate restrictions.

In **Australia**, the consumer organisations that were interviewed strongly favoured the introduction of a national rate cap, as described above, as a means of reducing the availability of high-cost short-term loans and thereby protecting consumers. They regarded a rate cap as the only effective means of regulating this part of the credit market.

Where rate caps had been recently introduced in New South Wales, respondents reported that some lenders had complied, while other lenders had left the market (either voluntarily or following regulatory action). In their view, enforcing the new legislation was much more straightforward and as a result cheaper (for regulators and debt advice providers). The regulator had intervened to tackle avoidance practices among some lenders, and from their own experience there were fewer debt cases being reported to advice centres. In the absence of high-cost loans, respondents considered that borrowers would go back to using

the strategies they had used in the past – such as borrowing from friends or family, going without, or getting help from charities.

## 5.4 Social lending

Across the three countries, the view was that social lending was relatively small-scale and under-developed, with the potential for both governments and the financial services industry to play a greater role in helping the sector to grow. In the **UK**, the view was that without further (government) investment credit unions and other not-for-profit lenders were only able to ‘scratch the surface’ of the need for affordable credit among people on low incomes. There was a strong feeling that the industry had a greater role to play, if not as a direct provider (which seemed unlikely in the case of mainstream banks and lenders) then to support the provision of lower-cost credit to people on low incomes, possibly through partnership working. Central government was regarded as a key driver for greater industry involvement; views differed about the extent to which corporate social responsibility was an effective vehicle for delivering changes in social lending provision.

In **France** (and Belgium) social lending usually involves a partnership approach between government, the banking industry and not-for-profit organisations. For example, public authorities guarantee funds for social lending through the Social Cohesion Fund (as described in Section 3). It was reported that co-operative banks were much more heavily involved than commercial banks, with a view that there was certainly more scope for commercial banks to play a role.

In **Australia**, there are a number of social lending schemes for people on low incomes such as NAB’s No Interest Loan Scheme (NILS) (see Table 13), the Step Up loan scheme and Progress Loans from ANZ (see Table 14). In a model similar to that described in France, both these schemes are delivered by charitable organisations with financial support from major banks and the government.

It was striking that the consumer organisations we talked to in Australia did not regard these social lending schemes in any way as a substitute for high-cost lending. Rather, the conditional nature of the loans (with decisions at least partly based on the purpose of the loan) meant that these schemes were seen as ‘productive’ forms of credit. Respondents considered that it would be unacceptable (and irresponsible) for these social lending schemes to extend loans for the purpose of everyday needs such as bill payment or to pay for Christmas or holidays.<sup>12</sup>

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<sup>12</sup>[www.consumerbadcreditguide.com/](http://www.consumerbadcreditguide.com/)

**Table 13: NAB’s No Interest Loan Scheme (NILS)<sup>13</sup>**

The No Interest Loan Scheme (NILS) was developed by Good Shepherd Youth & Family Service nearly 30 years ago; today the Good Shepherd Youth & Family Service accredits organizations to be NILS providers in Australia. The National Australia Bank (NAB) is one of the main providers of NILS. NAB offers small, no interest loans for people on low incomes for the purchase of essential household goods. Loans are safe, and affordable – in the region of \$800 to \$1,000 – and are completely free of interest and fees. NAB has provided \$15 million to expand NILS across Australia, as part of NAB’s \$130 million capital boost to support lending to low-income groups. Over time, NAB’s support of the NILS network is expected to treble the number of interest-free loans currently offered to Australians living on low incomes. With NAB’s investment, the NILS program’s expansion will also focus on communities experiencing increasing disadvantage including Aboriginal and Torres Strait communities. The NILS capital supplied by NAB, will essentially become community funds lent on an ongoing basis for continual ‘recycling’ by community-based no interest loans providers.

**Table 14: Progress Loans from ANZ<sup>14</sup>**

Progress Loans give people in Victoria on low incomes access to loans of between \$500 and \$3,000 to pay for essential household items (or up to \$5,000 for a car). This is a joint program between the Australia and New Zealand Banking Group (ANZ) and the Brotherhood of St Laurence. An interest rate of 12.7% applies and the loan repayment term is flexible to suit the borrowers’ needs and can range from a 1 year to a 3 year period (Wilson 2008).

ANZ with partner organisation Brotherhood of St Laurence has taken the decision to tackle the issue of ‘safe and affordable credit’ by offering Progress Loans to those on low incomes who may not otherwise get a loan from a bank. The Brotherhood of St Laurence was granted \$1 million from the Commonwealth Government to help establish the Progress Loan scheme with ANZ. The aim is to help low income earners and those ‘underserved’ by banks who often have little or no experience with banks and credit. This approach to credit involves active recruitment of customers and the government grant has been used to help pay for the administration of the Progress Loans scheme. The Brotherhood of St Laurence employs ‘product champions’ who work in the community to promote the Progress Loans. ANZ retain the right and responsibility for risk assessment for Progress Loans and carry out risk assessments on applicants.

The Progress Loan scheme has been operating for a number of years and 1,400 loans have been granted, and ANZ has loaned around \$3.5 million in total to date. Progress Loans are set at a commercial rate and so they are viable from the ANZ business perspective, however this model of credit is costly to administer and has been dependent on government funding which will end in June of this year. It is too early to judge the long-term viability of Progress Loans, ANZ and the Brotherhood of St Laurence are still establishing and developing the model which has been labour intensive and costly to date. Future development will see ANZ looking to distribute Progress Loans and recruit through other channels and a dedicated phone line has now been set up for people to enquire about Progress Loans. The progress loan scheme needs to build scale and capacity to reduce costs which are labour intensive if the model is to succeed in the future, growing the volume of lending will be key to success.

<sup>13</sup>[http://www.nab.com.au/wps/wcm/connect/nab/nab/home/about\\_us/7/4/3/3](http://www.nab.com.au/wps/wcm/connect/nab/nab/home/about_us/7/4/3/3)

<sup>14</sup><http://www.anz.com/about-us/corporate-responsibility/framework/financial-capability/progress-loans/>

## 5.5 Summary

The small number of investigative interviews we carried out for this study provided a range of perspectives on the issue of credit provision for people on low incomes. Concerns were expressed not only about the cost of credit but also the difficulties that people on low incomes could experience using some forms of credit that were not appropriate to their circumstances or needs, such as revolving credit facilities.

The interviews also highlighted the importance of taking the wider social environment into account in any discussion about interest rate restrictions. Factors such as the levels and nature of welfare benefits and public services have to be considered when thinking about the resources available to people on low incomes and their possible need to borrow. In the UK, for example, proposed changes to the discretionary Social Fund may have significant implications for people on low incomes in terms of the options they have for obtaining money for larger expenses or in an emergency.

All the respondents we spoke to described the small-scale nature of social lending in their respective countries. The involvement of the financial services industry in supporting social lending was clearly welcomed, but it was generally felt that the industry could (and should) do more, either as part of their corporate social responsibility strategies or (preferably) as part of their core business. It was notable that, in Australia, social lending was not in any way regarded as a substitute for high-cost commercial credit (at least by the organisations we spoke to). Rather, social lending was largely restricted to purposes that were considered productive, such as to purchase large items or for education or training. The ability to afford everyday expenses such as utility bills or rent was considered to be a separate policy issue which social lending was not best-placed to address.

## 6 Summary and conclusions

### 6.1 Summary

The economies of France and Germany are comparable to the UK but both have managed to secure greater levels of financial inclusion compared to the UK, as has Australia, another comparable OECD country. France and Germany have lower levels of household debt, and the consumer credit market is more tightly regulated compared to the UK; through the application of interest rate restrictions. There are some concerns that low income families in France and Germany may not be able to access certain goods and expenditures that cannot be accommodated in their weekly or monthly budget because of poor access to credit. This view is often disputed in the literature, however, and the evidence is not clear as the data available on access and use of credit is limited, particularly in relation to low income families. The available evidence does suggest that the sub-prime sector in France and Germany is small, at least in comparison with the UK sub-prime market, suggesting that the credit industry in France and Germany may struggle to innovate and design financial products for the sub-prime market in the face of interest rate restrictions.

On the other hand, we have the more liberal UK and Australian systems which have allowed the credit industry more scope for self regulation. In the UK and Australia, the size of the credit market is significant. Table 5 shows the UK market to be worth 16.2 per cent of GDP, in France the figure is eight per cent and in Germany it is nine per cent of GDP. Access to credit is not seen as a significant issue for low income families in the UK and Australia as the market does offer solutions, and there is some social lending as well. In both countries, however, it is agreed that the high-cost of credit can place burdens on those struggling to manage on a low income, so that families can find themselves trapped in a cycle of debt.<sup>15</sup> Issues over 'affordable'/'extortionate' credit are often left to the local courts to decide what is acceptable (or unacceptable) when it comes to settling debt with creditors. In recent years there has been growing pressure on the UK government to better regulate the credit market, and there continues to be a heated debate about possible interest rate restrictions. A similar picture emerges in Australia, which is also presently engaged in reform of its credit markets.

In contrast, in Germany and France regulations of consumer credit interest rates have been in effect for a long time. There is some evidence to indicate that access to credit can be difficult, particularly for low income households, but access to credit is not seen as positive if the quality of this access is poor and results in extortionate lending. This is a trade-off that appears to be accepted in France and Germany.

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<sup>15</sup>Mainstream credit can also put people into situations of unmanageable debt, particularly once penalty fees and charges are applied (e.g. unauthorised overdrafts).

## **6.2 Conclusions**

This comprehensive review of literature suggests tentative conclusions under seven broad headings:

- financial inclusion
- information
- monitoring
- high street banks and building societies
- social banking
- choice
- regulation
- living standards.

### **6.2.1 Financial inclusion**

The comparative evidence on financial inclusion in the EU suggests that more needs to be done to improve levels of financial inclusion in the UK. The European Commission's measure of 'financial inclusion' is based on data from 2003, however, and urgently needs to be improved and updated. Since 2003, banking inclusion in the UK has increased considerably, although there remain concerns about the use that people on low incomes make of their accounts.

### **6.2.2 Information**

Consumers need good reliable information to make informed decisions when deciding to take out a loan. Information provided by lenders on interest rates and fee structures needs to be clear, reliable and understandable.

The UK credit market would operate more efficiently if consumers had reliable documented credit histories, and the OFT argues that new systems are required in the UK to achieve this (OFT 2010b). The lending regime in Germany, for example, is underpinned by a comprehensive national credit reference database with exceptionally wide coverage and social acceptance.

Financial capability is about managing money, making decisions and planning ahead (Financial Services Authority 2005). Greater efforts are required to improve and measure the financial capability of consumers with financial literacy programmes and the like which build on recent efforts to promote the financial capability of consumers in the UK. A baseline survey was conducted in 2005 but a follow-up is now required to track changes in people's financial capability within the UK.



### **6.2.3 Monitoring and regulation**

The UK needs to foster a culture of fair and responsible lending. The credit industry in the UK could do more to establish clear and accepted codes of practice among suppliers of credit; there is a clear role for better self-regulation by the credit industry.

There is a good argument for improved monitoring of the credit sector in the UK; the OFT or its successor body is well placed to perform an expanded oversight and reporting role.

Whether the UK requires interest rate restrictions is currently a matter for debate; the issue appears complex, the evidence that is available on the effects of caps in France and Germany is openly disputed. Here we shy away from any straightforward answers. Clearly there is a danger that the sub-prime credit market in the UK may suffer if caps are introduced. However the evidence about the impact of interest rate restrictions on credit access for people on low incomes is suggestive, drawn from other countries such as France and Germany with very different credit histories and cultures, so that simply extrapolating alternative models of credit to the UK context is far from straightforward. It is possible that interest rate restrictions, if introduced in the UK, might reduce access to credit for low-income consumers but many, such as the organisations under the Better Banking campaign umbrella, argue that the quality of credit is not good if it is not affordable for low income consumers. There is a need for more reliable information to help shape the debate on interest rate restrictions; this could take a number of forms and could include more public debate about the (appropriate) balance to be struck between the real risks and costs of credit for lenders and low income consumers in the UK. Evidence on the strength of public views and opinion on high-cost credit lending and the support for interest caps in UK is weak and inconclusive. New research could objectively engage UK public opinion on these issues and public opinion surveys in particular.

### **6.2.4 High street banks and building societies**

There is a strong and credible argument that high street banks in the UK could do more to make affordable credit available to those on low and minimum incomes. In Australia, major banks have teamed up with leading charities, and with the help of government funding they have been able to offer affordable loans to low income families in Australia (albeit with conditions often placed on the purpose of the loans). The Australian experience offers valuable lessons for thinking about how to promote affordable credit in the UK and a better dialogue with UK banks is needed about the potential nature and scope of social responsibilities.

### **6.2.5 Social banking**

The UK Coalition government's vision for developing a 'Big Society' should be welcomed with the promise of investment in social innovation and the third sector. There is clearly a need for better social banking and third sector lending in the UK and this is likely to involve renewed commitment and investment from the British government if this is to be a success as recent experience in Australia demonstrates (see Section 3.5). Consumer Focus has urged the government to make continued and improved investment in social lending through credit unions and community-based initiatives (Burton 2010). There are renewed efforts to boost the social banking sector in the UK, especially with the closure of the Growth Fund in March 2011 which provided an important source of affordable credit for low income families in deprived areas. Low income families and consumers are increasingly likely to need opportunities to save small sums of money against future financial difficulty and borrow at affordable rates in times of crisis.

### **6.2.6 Choice**

Low income consumers in the UK need improved choice of affordable credit options. New third sector partnerships with government and industry are now required to offer affordable credit and social banking options for low income families.

### **6.2.7 Living standards**

There is a plausible argument that the government could do more to ensure that families in the UK are living above the minimum level of income that the public finds acceptable to maintain a decent standard of living (Davis *et al.* 2010; Dowler 2010). Ensuring that families receive a decent income for healthy living may also help to reduce levels of credit use which we see among low income families in the UK.

In summary, the review has highlighted a broad level of consensus in the UK on what needs to be done and the way forward in the UK:

- better information, with clear fee structures as already described
- improved choice for consumers
- better and more responsible lending practices embedded in the credit market
- increased need for social banking and third sector lending
- improved monitoring of activity in the UK credit market
- more could be done to improve levels of financial inclusion in the UK
- greater efforts to improve financial capability and financial literacy in the UK.

Opinion on interest rate restrictions is divided in the UK. France and Germany have long capped interest rates to help prevent extortionate lending practices but there is debate on the extent to which the strong regulatory framework has disadvantaged low income consumers. The evidence on the pros and cons of interest rate caps for low income

consumers and the credit industry is unclear and disputed. If interest rate restrictions are introduced in the UK it is plausible that low income families may find it more difficult to access credit but many may feel this is a price worth paying. In France and Germany this trade-off appears to be accepted but the history, culture and use of credit in these countries is very different to that of the UK which has tended towards a more liberal, small state tradition of governance. In considering the use of interest rate restrictions, it is also crucial to consider the wider social environment in relation to levels of welfare benefits, public service provision and wage levels.

### **6.3 Suggestions for further research**

Evidence on the strength of public opinion and public views on high-cost credit lending and interest caps in the UK is weak. If we accept that the issue of interest rate restrictions is a moral issue, at least in part, then it would appear prudent to objectively gather UK public opinion to inform this debate and future policy relating to credit market regulation within the UK. More work could be done to test general public opinion in this field, particularly the extent to which government should play a crucial role to address problems of access and use regarding credit and the strength of public opinion on this.

Improving the financial capability and financial literacy of UK consumers is essential to encourage better and more responsible credit borrowing; a baseline survey of financial capability was established by the FSA in 2005 (Atkinson *et al.* 2006), and a follow-up survey is now required to track changes, and progress, in people's financial capability within the UK.

The European Commission has measured levels of financial exclusion in EU countries by drawing on Eurobarometer Survey data which was collected at the end of 2003 (European Commission 2008). It is important therefore to note that the Eurobarometer data is useful to draft a broad picture and to be able to draw very rough international comparisons but is now in urgent need of updating.

Further research might consider the potential impact for borrowers of any ban on payday lending in the UK as Consumer Focus has observed (Burton 2010).

Information on household debt by household income is not captured in international data and so it is difficult to assess levels of household debt in low income families in a way that makes it possible to compare across the various systems of credit regulation. Improved international monitoring and reporting of household debt levels by family income would help to shed further light on the impact of consumer credit market regulation in different countries and we recommend this as an area for further research.

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## Appendix 1: OECD data overview (2008 data)

	Definition (unit)	United Kingdom	France	Germany	Australia
<b>Population</b>	Population (000s)	61,412	61,840	82,772	21,016
<b>Affluence</b>	GDP (Billion US dollars, current prices, purchasing power parity)	2,185.96	2,121.72	2,909.69	831.25
	GDP per capita (US dollars)	35,631	33,090	35,432	38,637
	Unemployment Rate (Percentage of labour force)	5.60	7.90	7.30	4.20
<b>Social Security (2005 figures)</b>	Public Social Expenditure (as a percentage of GDP)	21.29	29.17	26.75	17.11
	Public Health Expenditure (as a percentage of GDP)	6.70	8.80	8.20	5.80
	Public Pension Expenditure (as a percentage of GDP)	5.47	10.58	11.01	3.24
<b>Income Inequality (2005 figures)</b>	Income inequality: Gini coefficient, level <sup>16</sup>	0.34	0.28	0.30	0.30
	Income inequality: Gini coefficient, rank	23	13	15	16
<b>Hourly Minimum Wage<sup>17</sup></b>	Hourly Minimum Wage (US dollars)	9.40	11.86	-	9.96
<b>Poverty<sup>18</sup></b>	Below 60% Median Income (mid-2000s) – (Poverty rate after taxes and transfers).	15.50	14.10	17.20	20.30
	Children in Poor Households	10.10	7.60	16.30	11.80

<sup>16</sup>The Gini index measures the extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. A Gini index of zero represents perfect equality and 100, perfect inequality

<sup>17</sup>Real hourly minimum wages are statutory minimum wages converted into a common hourly pay period for the 21 countries for which they are available.

<sup>18</sup>Percentage of people with an income below 60% of median income.



## Appendix 2: Foundational Principles for Community Development Finance Institutions in Australia

- Context - CDFIs should be developed for the uniquely Australian context;
- Focus - CDFIs should focus on addressing financial exclusion of individuals, social enterprises/businesses, and community sector organisations;
- Purpose - CDFIs must have a social purpose and aim to deliver wealth creation and asset building into communities that are most disadvantaged or underserved;
- Synthesis of Skills - CDFIs should synthesise the best of private, public and community sector strategies, skills and knowledge;
- Sustainability - CDFIs must be structured for sustainability;
- Social Impact - CDFIs must be impact focussed organisations.
- Support and Capacity Building - CDFIs must build the capacity of people, businesses and organisations in the markets in which they operate;
- Innovation - CDFIs should seek the leading edge of innovation in addressing financial exclusion;
- Enabling Policy and Regulatory Environment - CDFIs should be supported and monitored through appropriate policy and regulation;
- 10. Source of Capital - CDFIs should be structured to enable capital and investment to be sourced from a diverse base - with the majority of their funds coming from capital markets to ensure their long-term sustainability.

Source: Foresters Community Finance (2009).

## Appendix 3: PFRC investigative interviews

### Semi-structured interview schedule

- In your view does [country] have particular problems relating to (1) financial inclusion and (2) affordable credit for low income consumers?
  - what does 'financial inclusion' mean in [country]?
  - what is the scale of the problem in [country]?
  - what policies are in place to deal with the problem?
  - are low income consumers able to access affordable credit in [country]?
  - how are low income consumers defined in [country]?
- What are the key components of consumer credit market regulation in [country]?
  - policy aims
  - regulatory measures
  - probe for particular measures, e.g. list and include interest rate capping/price control/regulation
- How effective is this regulatory approach in achieving policy goals?
  - what are some of the key advantages and disadvantages of this approach?
  - how might the regulatory approach be improved?
- What should be the role and responsibility of governments to address problems to do with access and use of credit services?
- What is your view of interest rate restrictions/capping as a regulatory mechanism?
  - to what extent do interest rate restrictions protect or disadvantage consumers? For example, reduce credit costs for customers? Result in less product choice? Result in lower credit access?
  - to what extent do interest rate restrictions hinder the financial services industry and the sub-prime market, making it hard for industry to develop and market products? To what extent is this as positive or negative?
  - are there unintended consequences of interest rate restrictions/price controls for consumers and/or the financial services industry? What are they and are they positive or negative?
  - aside from caps/price controls, are there any other regulatory measures in the regulator's toolkit which have been helpful for consumers of credit, particularly those on a low income?
- Does [country] have a thriving and innovative social lending or social banking sector?
  - to what extent has this been promoted by government in [country]?
- Should the government do more to promote social lending and if so what?
  - how might this be better promoted?
  - explore issues of policy aims and how these might be at odds with either financial services industry and or low income consumers
- To what extent does the financial services industry support social lending in [country]?
- To what extent should government let the market operate with little constraint and leave affordable credit provision to third sector providers in [country]? such as credit unions or co-operatives
- Do you have any further comments on affordable credit in [country] or wish to draw attention to any issues not covered?



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