Extortionate Credit in the UK

A report to the DTI

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Contents

Extortionate credit in the UK - summary and recommendations

The Personal Finance Research Centre was commissioned by the Department of Trade and Industry to undertake research to determine whether extortionate credit is a significant problem for consumers in the UK, which consumers are most vulnerable to it and what steps could be taken to alleviate the problem. For the most part, this was based on desk research, but included 13 interviews with key informants from the credit industry, enforcement authorities and consumer organisations.

The research has found that only a relatively small number of people have loans whose costs terms and conditions would be considered extortionate however that were defined – no more than a few hundred thousand at most. These are, however, the most vulnerable people in society who are prey to unscrupulous lenders. In addition, however, several million more people have loans with specific terms and conditions that could be considered extortionate, even though they are dealing with reputable companies.

- Those most affected fall into two groups. First, people living on very low incomes who require small loans for short periods of time. Within this group, lone parents, the long-term unemployed, hostel dwellers and people living in areas of high crime being especially prey to unlicensed lenders or licensed ones who indulge in extortionate practices. Second, people with a history of bad debt and county court judgements, who are often seeking secured debt consolidation loans.

- The first of these groups uses an alternative credit market, comprising home collected credit, pawnbrokers and new entrants such as Cash Converters, Crazy George and cheque cashers. Users of this market do so for positive as well as negative reasons. So, while they may have little choice, the creditors they deal with offer products that are tailored to the needs of low-income budgets. The main concern here relates to the high cost of loans, but there are specific concerns about the practice of roll-over loans. At the least reputable end there is a small but unpleasant market of unlicensed lenders and unscrupulous licensed ones, who target those who are unable to get a loan from any other source. Here it is the debt recovery practices that give rise to particular concern.

- The second group uses the non-status credit market and, in particular, the less reputable end of it dealing in secured loans with punitive terms and conditions. In contrast to the alternative credit users, this group turns to the non-status market solely through lack of choice and often when they are in serious financial difficulty. Here there are major concerns about the practice of equity lending – loans determined not by the borrower’s ability to repay, but in the level of equity securing the loan. This is almost inevitably accompanied by terms that increase substantially the level of charges on loans that are in default and penalise borrowers who settle long-term loans early. It is this market that is cause for greatest concern – because the consequences for borrowers are more acute than they are in the licensed alternative credit market.

- A number of factors have fuelled the development of the alternative and non-status credit markets generally and the extortionate ends of them in particular. These include: the growth in demand for credit, and for forms of credit that cannot be met by mainstream credit companies (small cash loans and for non-status credit, especially for debt consolidation); lack of information especially for vulnerable consumers; and lack of more suitable alternatives for those who are most vulnerable.

- On the whole, the Consumer Credit Act 1974 has proved inadequate to deal with many of the current extortionate practices. Few cases are brought to court, because the onus rests with borrowers to initiate proceedings. The wording of the Act is too imprecise and the judicial decisions have been based on a restrictive interpretation of its provisions. The penalties of the Act are inadequate for dealing with extortionate bargains, with persistent offenders or with unlicensed lenders.

- In addition, there are inadequacies at all levels of the enforcement process. Borrowers are reluctant to co-operate with legal proceedings. Both trading standards departments and the Office of Fair Trading lack the resources to collect the level of proof required to revoke a licence or to prosecute unlicensed lenders. And the prosecution of different aspects of unlicensed lending is fragmented between trading standards departments, the police and the Benefits Agency (in the case of the holding of benefit books as security for loans.

- At the same time, the market for extortionate credit is encouraged by the paucity of consumer information in relation to both the costs and, perhaps more especially, the terms and conditions of loans. Those prey to the worst extortionate credit practices invariably have no alternative course of action. There is a need for national provision of social loans for those living on low incomes. At the same time, those who use extortionate secured non-status creditors require an adequately funded national debt advice service that is free at the point of use.

Recommendations for improving consumer protection

There a number of ways in which vulnerable consumers could be given better protection. These include improving the legislation, improving the enforcement of that legislation and offering an alternative to the use of extortionate credit.
The legislation on extortionate credit could be improved in a number of ways.

- Third parties should be allowed to initiate proceedings on behalf of borrowers.
- Judges should be able to re-open cases on their own initiative.
- Information and guidance on interest rates and credit terms and conditions should be provided to judges to help them identify extortionate credit agreements and provide the appropriate forms of redress.

Legislative changes regarding costs, include:

- Interest rate ceilings should only be considered in conjunction with measures to ensure that social lending facilities are available to people who would be unable to obtain loans at interest rates below the ceiling.
- Consideration should be given to setting presumptive interest rate ceilings, above which a lender would have to justify their charges but only with the same proviso, set out above in relation to absolute ceilings.
- The regulations concerning costs and APRs should be reviewed in order to make credit transactions more transparent.

While legislative changes relating to the terms and conditions of loans include:

- Non-status lenders offering secured debt consolidation loans should not be permitted to take possession of the property, unless they can prove that they checked the borrower’s ability to repay at the time the loan was agreed.
- The regulation of discounted interest rates on secured loans should be tightened.
- The legislation regarding the linkage between brokers and lenders in cases of secured lending should be re-assessed and, where appropriate, tightened to increase lenders’

responsibility for the actions of the brokers, and make brokers more accountable for the loan agreements they arrange.
- The suitability of the rule of 78 for long-term loans should be re-examined

Finally, there is a need for tougher penalties both for lending without a licence and for breaking other provisions of the Consumer Credit Act.
- All similar agreements issued by the lender should be re-opened if one of them is found to be extortionate by the courts.
- The Office of Fair Trading should be notified of all judgements involving extortionate credit, and repeat offenders should have their Consumer Credit licences revoked.

Improving enforcement is largely a matter of additional resources both for trading standards departments and for the OFT.
- The current fragmentation of enforcement against unlicensed lenders should be reviewed and addressed.
- Trading Standards Departments and other enforcement agencies should be allowed to initiate proceedings on behalf of borrowers against lenders who are issuing extortionate credit agreements.
- Additional resources should be made available to Trading Standards Departments, the Office of Fair Trading and other enforcement agencies to enable them to collect evidence against lenders who are issuing extortionate credit agreements.
- Consideration should be given to ways of reducing the level of proof, particularly the proof of ‘persistency’, required for the Office of Fair Trading to revoke a Consumer Credit licence.

Finally, some potential solutions lie entirely outside the processes of law.
- A consumer information campaign is necessary to raise awareness of the key factors borrowers should take into account when seeking credit. This should be wide-ranging, including adverts on television, radio and in tabloid newspapers. However, targeted campaigns should also focus on particular geographical areas where unscrupulous lenders are known to operate.
- Alternatives to extortionate credit, such as social credit and debt advice, should be made available, provided with secure funding and widely advertised. This should include a national free-phone service offering advice, self-help materials and referral to specialist advisers.

1 To what extent is extortionate credit a problem in the UK?

The extent to which extortionate credit is a legal or social problem in the UK is difficult to determine with confidence, not least because there is currently no comprehensive definition of what an ‘extortionate’ credit bargain actually involves. The OFT has referred to this difficulty as *‘the troublesome and deeper problem of definition and circularity’* (OFT, 1991, p18). The current legislation, contained in sections 137-140 of the 1974 Consumer Credit Act, identifies the factors to be taken into account in determining whether or not an agreement is extortionate. The Act was not, however, intended to provide a definitive answer as to what constitutes an ‘extortionate’ credit bargain but rather to provide the context for judicial decisions.

Moreover, attempts to identify the extent to which extortionate credit is a problem in the UK are also hampered by a number of other factors. First, the subject has become very emotive, fuelled, at least in part, by sensationalist press coverage. Second, the debate frequently takes a very narrow perspective, focussing primarily on weekly home collected credit companies (often referred to as moneylenders) rather than other lenders. Related to this, is a tendency to assume that expensive credit automatically constitutes an extortionate bargain, and to confuse regulated credit agreements, which can be addressed under the Consumer Credit Act, with illegal or fraudulent lending, which requires very different legislative solutions. Hence the term loan shark is used indiscriminately to describe any lender whose charges are thought to be high.

Finally, there is a clear tendency among some commentators to believe that the high profits among the credit companies that target low-income households, mean their charges are unreasonably high and, by definition, exploitative. Yet turnover figures, which can be calculated in a number of different ways, are not always directly comparable. In addition, just as high costs are not automatically indicative of extortionate practices, it is unreasonable to assume that high profits are necessarily unjustifiable. *‘If [a large multi-national company] is entitled to maximise profits, is it realistic to expect the low-income merchant to respond differently?* (Cayne and Trebilcock, 1973, p.400).

Yet even without these definitional problems, the extent to which extortionate credit constitutes a problem in the UK remains difficult to measure due to the geographically and socially concentrated nature of much non-mainstream lending activity.

Despite these difficulties, a wide consultation exercise conducted by the OFT in the early 1990s and again in 1997 (OFT, 199) elicited broad agreement on the nature of the problem. While most lending was deemed to be unproblematic, extortionate credit was identified as a concern in a very narrow sector of the credit market and for a fairly small group of consumers. Our own interviews with key informants would support this view.

However, while the problem may not be widespread, it remains a significant issue because the small group most likely to be affected are among the most vulnerable consumers in the market. That is, consumers who engage in ‘necessitous borrowing’ for ‘the management of poverty’ rather than *‘the facilitation of affluence’* (OFT, 1991).
A number of characteristics are associated with people in this position which adds to their vulnerability. Compared with other groups in society they:

- are people who perceive, or are persuaded, that borrowing is the answer to their financial difficulties
- have a limited choice of lender and have little or no bargaining power

- are less well-informed about credit generally
- are hit harder by high charges
- and are at greater risk of default and likely to face more severe consequences should default occur.

This issue has continued to generate concern as the number of people without access to mainstream credit has almost certainly increased. Several factors lead us to this conclusion. First, there has been a substantial restructuring of the labour market with growing numbers of low-income households now, additionally, facing a more ‘flexible’ labour market, offering them far less job security (Ford, Kempson and England, 1997; Gregg and Wadsworth, 1998; White and Forth, 1998). Secondly, there has been an upward trend in relationship breakdown and in the numbers of lone parent households living on low incomes. Thirdly, the economic recession during the early 1990s resulted in a massive increase in mortgage arrears and possessions and consumer credit debt leaving hundreds of thousands of people with County Court judgements (Ford and Kempson, 1995). Given the *‘striking inelasticity’* (Cayne and Trebilcock, 1973) of demand for credit among these vulnerable households it is likely that, rather than decide against borrowing, people turned away from mainstream lending institutions are forced to look for sources of credit. Consequently, the number of consumers who are, potentially, exposed to the risk of extortionate credit will almost certainly have grown in the last decade.

The market in which extortionate lending practices are, potentially, problematic can be described in two ways. Either;

- in terms of the types of lenders who are most active in this segment of the credit market; or
- in terms of the lending practices which are most commonly associated with extortionate credit bargains.
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Neither approach, alone, gives a complete picture of the nature of the problem, although each contributes to an overall understanding of it.

1.1 The lenders most commonly associated with extortionate credit

The types of lending institutions that give greatest cause for concern in relation to extortionate credit fall into two distinct groups, offering different services and, on the whole, catering to different types of customer. The first, which has been termed the ‘alternative credit industry’, is long-standing and exists primarily to meet the needs of low-income households requiring access to small sums of money for relatively short periods of time. It, therefore, caters largely for people whose needs are not adequately met by the mainstream credit market.

The second group, ‘non-status’ or ‘sub-prime’ lenders, is rather newer and consists of companies that have more similarities with mainstream lenders. They cater, however, specifically to customers who have difficulty gaining access to mainstream provision, because they are considered to be ‘high risk’ or have a history of bad debt.

1.1.1 Alternative credit providers

Perceptions of extortionate credit tend to focus on this group of lenders and, in particular, on ***weekly collected credit companies (moneylenders)***, who make small cash loans and collect the repayments, in person, from borrowers’ homes, and. Altogether it is estimated that there are about 1,200 licensed companies offering cash loans, credit vouchers or retail credit agreements in this way (Rowlingson, 1994 and updated by the Consumer Credit Association). Some companies specialise in just one of these types of credit, others offer more than one. Unlike other creditors these companies employ agents who are paid on a commission basis and visit customers in their homes, both to arrange the credit and to collect the repayments. There are five national companies, each of which employs at least 1,000 agents, - Provident, London Scottish, Morses, Shopacheck and S & U. Provident is the biggest by far, and accounts for around a third of all moneylender customers. There has been a recent new entrant at the national level, Park Hampers, but their loan book is still small. In addition to these national players, there are:

- 50-60 medium sized companies that employ 50-100 agents each and tend to be regional in coverage
- 700 small local companies, that employ an average of 10 agents each
- 400 sole or very small traders, with perhaps one employee.

There seems to be a degree of competition in this sector and most of the people interviewed for the survey of moneylenders and their customers had experience of using more than one company – often simultaneously (Rowlingson, 1994). Concerns expressed about licensed moneylenders are their very high charges, the practice of roll-over cash loans and some sales practices.

It is important to recognise that many of the worst practices associated with the ‘alternative’ credit market are actually employed by ***unlicensed moneylenders*** who are lending illegally and so the terms of their agreements are not covered by the Consumer Credit Act. The debate on extortionate credit, however, has a strong and unhelpful tendency to blur the distinction between licensed and unlicensed moneylending.

In addition to the moneylenders, there are a number of other providers in this segment of the market about whom concerns have been raised. These include pawnbrokers and agency mail order companies, as well as several new forms of ‘alternative’ credit, which are aimed primarily at low-income consumers and have developed during the 1990s.

Pawnbroking, like moneylending, is a long-established business that caters for needs for small cash loans for short periods of time. There are no reliable statistics of the number of registered pawnbrokers, although the National Pawnbrokers Association estimates that there are around 800 shops in Britain. The 150 NPA members account for 300 of these shops. Most companies are small with just one shop; about 40 NPA members have more than one shop and, of these about 16 have more than five. The largest pawnbroker has only 40 shops in total. In other words, it is a much smaller sector than weekly collected credit and is much more dominated by small traders. Compared with moneylenders rather fewer concerns are raised in relation to pawnbrokers and these relate almost exclusively to cost.

Similarly, ***mail order companies*** are established providers of goods on credit and agency catalogues are an important source of credit for people on low-incomes. The agency mail order market is dominated by five companies – Great Universal Stores, Littlewoods, Freemans, Grattan and Empire Stores - and a proposed merger between Littlewoods and Freemans was recently investigated and blocked by the Monopolies and Mergers Commission (MMC, 1997). Although apparently offering interest free credit, agency catalogue companies have been criticised for the very high price mark-ups applied to the goods they sell and the consequent lack of transparency.

New entrants to the alternative credit market include ***cheque cashers***, that primarily cash third party cheques but also, for a fee, offer pay-day advances by cashing post-dated cheques.

Many cheque cashing outlets are, in fact, operated by pawnbrokers or moneylenders. They have been set up following the Cheques Act 1994, which resulted in all cheques being crossed a/c payee only. The network of outlets is growing rapidly and now stands at over 550 (BCCA Newsletter, Autumn 1998). Concerns, once again, relate to the charges they make.

Other new entrants are ***Cash Converters*** and ***Crazy George***. Cash Converters is an international franchise operation, which originated in Australia and has 96 stores across the UK (www.cash-converters.com.au 27.4.1999). The business has grown out of second-hand retailing and now offers customers selling goods the right to buy them back within a pre-determined period of time but at an increased price. In other words, it is a variant of pawnbroking. Like pawnbroking, Cash Converters has been criticised for the level of charges they make. But they have also been criticised because customers must choose from a range of different agreements with very different terms but have little time in which to do so.

The credit agreements offered by Crazy George are more complex. This is essentially retail credit for white goods, but with an optional service charge which entitles the customer to return the goods to the company's store if they cannot afford the repayments and reclaim them when they can afford to start repaying. Concerns relate to the costs and terms of these optional charges.

It is important to recognise, however, that while concern about the cost of the credit provided by alternative lenders is widespread, their charges are not necessarily extortionate.

1.1.2 Non-status lenders

This segment of the market is quite different from the 'alternative providers' described above. It comprises financial institutions that cater specifically to people for whom mainstream lending practices are, more or less, suitable, but who do not have a good enough credit rating to gain access to them. At its most respectable end, the activities of these companies closely resemble those of mainstream banks and building societies. They operate in a very similar way but provide credit at higher cost to cover the additional risks associated with their customer base. However, the least respectable institutions are very different from mainstream lenders. They not only lend at much higher interest rates and on rather different terms than the more respectable non-status lenders, but also cater for customers with a history of bad debt. Indeed, there is concern that some of these institutions specifically target vulnerable people and encourage them to take out loans that they are unlikely to be able to repay.

Loans from non-status lenders are frequently secured on the borrowers' property and it is this element of non-status lending which currently gives greatest cause for concern. In fact, people involved in the regulation of financial services and in offering advice to people in financial difficulty agree that secured non-status lending constitutes a bigger problem in relation to extortionate credit than alternative providers. Non-status loans can also be unsecured, although this usually only occurs at the most respectable end of the sub-prime market. These tend to be smaller loans, and are usually geared to a particular purchase, such as a car, or for home improvements.

Non-status loans are often arranged via a third party, who has a relationship with the lender and can apply for credit on behalf of the customer. With secured loans this is usually a broker, and the problems associated with this are explored in more detail below. Unsecured loans tend to be arranged by the organisation that provides the goods or services being supplied on credit, for example, a home improvements company or motor trader. While there are consumer protection issues associated with this dislocation between the borrower, lender and supplier, the resulting problems are less likely to relate to extortionate credit.

1.2 The practices which are commonly associated with extortionate credit

Following the distinction made by the legislation, the lending practices that tend to be associated with extortionate credit bargains can be divided into those relating to the substance of the agreement and those that relate to lending procedure.

1.2.1 Substantive factors

The most significant substantive factors associated with potentially extortionate lending are:

- the relatively high costs; and
- the terms of conditions of the agreements.

High costs of credit
The most frequently cited and most visible indicator that a credit agreement may be extortionate is the high cost of some forms of credit, in absolute terms and relative to credit from other sources. The areas of greatest concern include:

- high interest rates
- dual interest rates
- fees and charges
- non-compulsory insurance policies, where the borrower is led to believe otherwise
- late settlement of superceded credit agreements

The interest rates charged by both alternative and non-status lenders are usually much higher than among high street lenders. Indeed this is often the major criticism levelled at them.

The highest interest rates are to be found in the alternative credit market and in the ***moneylending*** or weekly collected credit industry, in particular. Interest rates vary according to the size and length of loans and range from 105% for a 104 week loan of £800 to 481% on a 20 week loan of £60 (Rowlingson, 1994, p29). It should be noted, however, that these charges include the costs of home collection as well as the costs of late payment. Indeed the Consumer Credit Association (the trade association representing the majority of such companies) has calculated that the cost of home collection is around 15% of the total sum collected by their agents. Of this 8% is paid as commission to agents and a further 7% covers management of the agents and back office loan and repayment administration of small weekly payments. So, for example, a £100 loan repayable over 26 weeks would incur total charges of £40. Of this £21 would cover the costs of collection (ie 15% of £100, plus £40). It is also claimed by the CCA that the majority of loans are not paid on time and, for example, a 26 week loan is typically repaid over 30 weeks. Taking both these factors into consideration would reduce the APR on a £100 loan from 292.4% to 82.8%.

Pawnbroking APRs tend to be slightly lower – between 40 and 85% for one large pawnbroker, depending on the amount borrowed and the goods pledged (www.thompsons.co.uk). In addition, there is usually an arrangement fee. Rates are lower than those charged by moneylenders, partly because pawnbrokers do not have the costs of home collection but also because all loans are secured by the property pledged. And it is for these reasons that their charges are criticised. However, like the moneylenders they have to recoup administrative costs against very small loans and they also have the additional costs of providing secure storage for the goods pledged.

Of the new entrants, ***cheque cashers*** offering pay-day advances have also been accused of making very high charges. Typically they charge a flat fee of around £2 plus 7-9% of the face value of the cheque. The flat rate charge for cashing a post-dated cheque for £100 a month early, for example, would be around £9, resulting in an effective APR of 181.2%. To be fair, however, the other option open to someone in this position would be to overdraw the account, for which the charges would be considerably higher – especially if it were unauthorised. One high street bank would charge 33.8% interest, plus £5 a month and £3.50 for each day the account is overdrawn by £50 or more.

Other alternative credit providers, including ***mail order companies*** and ***weekly collected credit companies offering retail credit***, typically sell products at artificially inflated prices in order to make the costs of credit appear lower ('colourable goods'). This is especially common in the mail order sector where the additional costs of one large and reputable company typically equate to APRs of between 100 and 200%.

Non-status lenders' interest charges tend to be considerably lower than the figures for either moneylenders or pawnbrokers but they are not strictly comparable for four main reasons. First, they do not include charges for home collection or storage of pledged goods. Secondly, additional charges can be incurred by borrowers that are not reflected in the APR. Thirdly, the size of loans is a good deal higher. And fourthly, many loans are secured against large amounts of property equity. Non-status lenders do, however, charge much higher interest rates than those prevailing for similar loans from mainstream lenders. The higher costs of non-status loans are intended to cover the additional costs of lending to a more risky population than mainstream banks or building societies.

Questions have, however, been raised about the high APRs on secured loans from non-status lenders, especially where security offers lenders a high degree of protection against bad debt. The National Consumer Council report quotes interest rates for secured loans that, on the whole, ranged from16 to 22%, but were as high as 32% 'for debtors'. At this time, the interest rates for unsecured bank loans was 16.7% and 20% for personal bank loans (NCC, 1987). Currently, with lower interest rates generally, secured loans are being advertised at around 13% for loans of up to £9,000, but with higher (unadvertised) charges for people with a history of bad debt. This compares with 13.9% and 14.9% being charged by two leading high street banks for unsecured personal loans of between £5,000 and £9,000. This, however, is the more reputable end of the market. One particular group of non-status lenders, targeting people in serious financial difficulties, is currently quoting flat interest rates of 18-25% on non-reducing balances. And recent court cases have involved loans secured on property with interest rates in excess of 40% APR

Concerns have also been expressed about the practice, in some sections of the non-status market, of applying discounted interest rates which are withdrawn if a single payment is late. This is explored more fully below.

However, it is not simply interest rates that render some non-status loans more expensive. Fees and charges can also make the cost of credit far higher than borrowers originally anticipate. For example, the National Consumers Council has documented some cases of very high charges, including an £800 charge for a loan of £2,000 (NCC, 1987). These costs are further inflated when fees and charges are deducted from the advance, reducing the amount of money which is actually lent, while interest is still charged on the total amount (NCC, 1987). Current advertisements by reputable secured lenders include fees of up to 10% of the loan for people with County Court Judgements or some other record of default. In the interviews, we were told of fees of up to £7,000 on secured debt consolidation loans of £25,000.

Similarly, there is evidence that borrowers are sometimes led to believe, falsely, that protection insurance is a condition of their loan. And because it is, in fact, voluntary it does not have to be included in the APR quoted. The costs of these insurance policies are also often added to the advance and, therefore, become subject to interest charges.

Finally, there are occasions where lenders or brokers fail to settle superceded agreements within a reasonable time period and leave borrowers needing to support two loans. The OFT notes this to be a particular problem in relation to loans for car purchase, where a vehicle is traded-in, triggering the cancellation of the original agreement and the issuing of a new one OFT, 1991.

Terms and conditions of agreements

The terms and conditions of some loans have also led to accusations of extortionate practices, especially in the non-status market. These include:

- levels of security required
- dual interest rates, with concessionary rates ending at an early stage of default
- conversion from unsecured to secured loans following default
- interest penalties for early settlement

Of particular concern is the level of security required by some lenders at the disreputable end of the market. In the non-status market this means loans secured on property that is valued far in excess of the size of the loan or far outweighs the borrower's risk of default. In the alternative market, unlicensed lenders usually demand unacceptable forms of security, such as benefit books or passports.

Other terms and conditions that give rise to concern are those that add to the costs of credit. Some agreements, for example, have in-built changes to their terms and/or conditions during the course of the loan, often as penalties for payment default. Increasing interest rates as a penalty for default is in breach of the Consumer Credit Act. Yet in recent years some non-status lenders have circumvented this legislation by offering loans with 'concessionary' interest rates for accounts which are up-to-date but with a much higher 'standard' rate which is applied immediately a payment is late, even if only by a matter of days. This practice was especially common in the sub-prime first mortgage market in the 1990s and there were many complaints to trading standards departments at that time. CIBC Mortgages (who no longer offer mortgages), with a loan book of 28,000, was especially criticised for this practice both in the press and by the judiciary. In one, unreported, court case involving CIBC, the discounted interest rate was 9.4% but increased to 17.95%, when the mortgagors were in default. Trading standards officers and citizens advice bureaux were asked to compile evidence for the Office of Fair Trading, who subsequently issued guidelines on this practice (OFT, 1997). The Office of Fair Trading investigated the City Mortgage Corporation and in February 1998, announced in a press release;

> *' … that the CMC (City Mortgage Corporation) will no longer enforce a higher rate of 18% on any borrower whose account falls or remains overdue. Instead its higher rate will be 12.4% compared with its usual 'concessionary rate' of 9.9%. What is more, the rate of interest only goes up to 12.4% where the borrower is in default by 3 months, and it falls again once the arrears are paid'*

Previously, the concessionary rate was forfeited almost as soon as the account went into default and the higher rate was payable for the remainder of the term of the loan.

Despite this well-publicised case and the OFT guidelines some non-status lenders are still using this practice and getting away with it. The most recent case we have been able to identify was Falco Finance Ltd v Gough (October 28, 1998) which was unreported but detailed in the New Law Journal (vol 149 (6870) p7, 1999). In this case, the discounted interest rate of 8.99% rose by 5% for the whole of the rest of the term, even if part of one instalment was paid one day late. The Finance and Leasing Association, however, have commented that this is an ‘extreme case’ (www.fla.org.uk/upfeb.htm). It seems that, even in the non-status market, some companies are willing to comply with consumer protection legislation and guidelines while a minority continue to find ways to avoid it and profit from doing so.

Even greater concern has been expressed about unsecured loans which can automatically be converted into secured agreements once a specified number of payments has been missed.

Finally, interest penalties for early settlement can also add disproportionately to the cost of a loan, particularly if the Rule of 78 is applied. While lenders must clearly be compensated for the loss of interest on loans which are repaid sooner than expected, money advisers and industry regulators have encountered early settlement figures which do not appear to be either reasonable or justifiable. This, too, has been a particular problem in relation to the non-status market and the Director General of Fair Trading has also called attention to this issue in the OFT guidelines for non-status lenders (OFT, 1997). This practice had been used by the City Mortgage Corporation, until they were investigated by the OFT. The February 1998 OFT press release also notes that:

> *‘CMC has undertaken not to apply a calculation known as ‘the Rule of 78’ plus a charge of 6months’ interest when unregulated loans (loans above £15,000) ar repaid before their full term. Instead it will use a settlement figure calculated on the actual reducing balance plus a set number of months’ interest depending on when the loan is redeemed – six months in each of the first three years, reducing by one month for each year thereafter and falling to zero after year eight’*

More recently, the Falco Finance case (quoted above) also involved a breech of the 1994 regulations on early redemption.

1.2.2 Procedural factors

The procedural factors which give cause for concern relate to:

- the targeting of loans to particular groups;
- the sales practices which some lenders engage in;
- the transparency of the agreements which people sign;
- the role of brokers and other third parties; and
- debt recovery practices.

Targeting

The concept of ‘socially harmful lending’ developed by the Crowther Committee in 1971 suggests that there are people who have such precarious circumstances or are so financially inexperienced that they should not really be borrowing money at all. This is the basis of much concern about the marketing of particular forms of credit. Evidence, particularly the on-the-ground observations of money advisers, suggest that some lenders specifically target vulnerable people, for whom credit is not necessarily the best option or who would not have considered borrowing had they not been approached and encouraged to do so. Specific concerns relate to:

- targeting low-income households at Christmas
- targeting people who are in financial difficulties
- canvassing credit on the doorstep

Particular questions have been raised about two forms of targeting. First, alternative credit companies that target low-income neighbourhoods at Christmas, offering vouchers or seasonal items such as hampers. And secondly, lenders that specifically target people who are in financial difficulty and offer loans as a solution to their problems. Some non-status lenders, for example, purchase lists of rejected applicants from other finance houses and then contact them to offer loans. This is particularly effective if people have already been rejected from more than one source and some lenders deliberately exploit this. Many lenders in the non-status market also advertise consolidation loans to people who are in debt as a solution to their problems.

Concern was also expressed by the people we interviewed about the fact that some credit companies – both alternative and non-status lenders – have found ways around the legislation which forbids canvassing credit ‘on the doorstep’. Some weekly collected credit companies offer vouchers for major retail outlets on the doorstep as a way of establishing a relationship with a householder which can progress into offers of cash loans. In addition, some non-status lenders advertise their services by inviting people to call a telephone number. This call is then interpreted as an ‘invitation’ for salesmen to call at their home.

Sales practices

The sales practices that tend to be associated with extortionate lending include:

- high pressure sales
- encouragement of a cycle of borrowing.
- roll-over loans
- failure to check borrowers’ ability to repay
- falsification of income data on application forms
- equity lending
-

High-pressure sales tactics and the failure to give borrowers sufficient time to consider their decision are most frequently associated with the more unscrupulous non-status lenders. Money advisers and those involved in representing borrowers in legal hearings have evidence of practices such as salesmen calling at people’s houses very late at night and not leaving for several hours until an agreement has been signed.

At the same time, weekly collected credit companies are also accused of ‘exploiting’ the personal relationships which collecting agents cultivate with borrowers to encourage people to take out loans. Related to this is the practice of encouraging people to take out ‘top-up’ or ‘roll-over’ loans. A study of moneylenders and their customers found that this practice was not deployed by all companies (Rowlingson, 1994). One national company was especially singled out for criticism, with many of their customers resenting being pressured in this way.

> *‘I mean she kept on for quite some time before, when he [her son] was coming towards the end, kept asking if he was interested in having another one and we kept saying no. Then he finished it and the same went with me and when my husband came towards the end, it was the last one and we did actually have another one with her then , in my husband's name. But I turned round joking and I said to her 'Are you happy now that you've had another one' and she says 'Well not really, no, because you haven't had one.'*
>
> *'Automatically, when she comes in, 'Aren't you going to have anything else yet'. You know, 'This is almost finished now and, you know, don't you think it's about time you had something' and you think 'Well, no, there's nothing I want, you know, I'm not taking out loans for the sake of it'.*

People who use weekly collected credit have to build up their credit-rating, being offered only small loans at the outset. Having reached the position where they are able to get larger loans they are reluctant to stop dealing with companies even if they do pressure them. Indeed, this was the case with one of the women quoted above, who had a credit limit of £1,000 with the company pressing her to renew her loan. Also, there is evidence that agents use the personal relationships they have built up with borrowers to pressure them into taking out further loans (Rowlingson 1994)
The situation is exacerbated when customers are encouraged to settle existing loans early, not least because few borrowers seem to be aware of the financial penalties levied for early settlement.

> *'You can get into a thing where you want more, you pay one loan and you haven't even finished and some people renew before it's finished, and then if you get into that, then that's pretty bad... Like before it's finished and you, say, owe ,30 but then that comes off so you borrow ,70, it's going to be £100.'*

Top-up or roll-over loans appear to increase borrowers' confusion over the terms and conditions of their loan making it harder for them to judge the amount they owe and the cost of their credit (Rowlingson, 1994; Kempson et al, 1994)

There is also evidence that some lenders issue credit without sufficient regard to the borrower's ability to repay. Weekly collected credit companies, for example, are accused by money advisers of issuing loans to people with very low income or who are already over-committed. This practice is also associated with the retail credit industry. This clearly causes problems for borrowers who may have difficulty making ends meet due to the repayments on a loan, as this exchange between two women customers shows.

> *R1 'They encourage you all the time to be in debt with them, you know what I'm saying'*
>
> *R2 'Even though you've got arrears or whatever, they still encourage you to have a loan'.*

One couple were in serious financial difficulties and in arrears with payments for rent, council tax and electricity, but their moneylender (a reputable company) encouraged them to take out a roll-over loan when they were three weeks from paying off their existing one.

> *'He got his wallet out and all you'd see was £10 and £20 notes and he said 'Right how much do you want?''*

It is unusual, however, for weekly collected credit companies to penalise borrowers for late- or non-payment, particularly if they are assessed to be 'can't pay' rather than 'won't pay' clients. Very few cases are ever taken to court.

In contrast, irresponsible lending is more serious in relation to non-status secured loans, as borrowers face losing their home if they are unable to maintain repayments. Money advisers, trading standards officers and the 'expert witness' we interviewed were all aware of cases where loans had been issued without taking account of individuals' income or outgoings. Consequently, the loans were way beyond borrowers' ability to repay. Indeed, the National Consumer Council report on secured lending noted that some companies were specifically advertising the fact that they did not run checks on income (NCC, 1987). Current advertisements are still targeting people who have a history of debt and 'no proof of income' or who are self-employed and have no business accounts.

A related problem occurs at the totally unscrupulous end of the market, where information about the borrower's income is falsified, sometimes to the point of forging wage slips. This often occurs where brokers are involved, but the lenders who deal with these brokers are believed to be aware of their practices. Borrowers clearly have a responsibility to check that the details on an agreement are correct before they sign it. Yet people go along with providing incorrect information because they are desperate for money or do not fully understand the implications.

Further, some of the least reputable non-status lenders are accused of 'equity-lending' – being more concerned with the value of a customer's security than whether or not they can maintain repayments. For example, we were told of one company that has recently been offering mortgages to council tenants, without assessing their ability to repay and even offering to 'buy out' rent arrears.

Lack of transparency in agreements

There is ample evidence, collected by money advice workers, by those involved in representing borrowers in the courts, and by researchers, that people are not always aware of the costs, terms and conditions of their loans or, more importantly, their full implications. Some of the areas of greatest concern are:

- lack of price transparency, including the problem of colourable goods – goods sold on credit at greatly increased prices to cover the costs of lending
- mis-representation or concealment of terms and conditions
- irregular and incomplete documentation

In the alternative market, the problems largely relate to price transparency and the sale of 'colourable goods'. As we have noted above, both mail order and goods sold on credit by the weekly credit industry are priced considerably higher than in high street shops. Voucher credit, too, is offered at a lower interest rate than cash loans and customers clearly recognise that they are paying for it in other ways.

> *'Why have they got to charge you more interest on cash than on vouchers? Obviously they must have a gimmick going with the stores…'*

In the non-status market, the problems are wider and include the use of discretionary interest rates, early settlement penalties and the risks attached to secured loans. In part, these problems arise because some people clearly do not completely understand the credit agreements that they sign up to, either because they are not fully explained or because they are inexperienced in borrowing and simply lack the 'knowledge map' necessary to process the information they are given. While there is a great deal of research which indicates that people do not always retain information they are given, lenders must take responsibility for explaining the details of credit agreements to customers. However, there is also evidence that the terms and conditions of credit agreements are misrepresented to clients or even deliberately concealed to increase the chances of customers agreeing to take out a loan. This practice is usually associated with the least reputable non-status lenders or with the involvement of brokers (see below).

An additional problem is loans that are issued with irregular, or incomplete documentation. This includes failing to provide information on cancellation rights, interest rates and APRs, and failing to borrowers copies of agreements or proper accounts of amounts paid. This makes it extremely difficult for borrowers to check the terms of their agreement or compare it with other sources of credit.

The role of brokers and other third parties

Most of the issues relating to third parties and extortionate credit agreements involve brokers, not least because they tend to be involved in much bigger loans and, more importantly, secured agreements. But there are also problems relating to retailers and other suppliers and, in some Asian communities, of people who act as 'go-betweens'. The main problem areas are:

- encouragment of irresponsible lending
- failure to disclose ties to lenders
- charging fees even if no loan is arranged
- deduction of fees from the loan
- linking credit agreements to sales agreements so that rights of cancellation are curtailed
- unlicensed brokers (go-betweens) in the Asian communities.

The main source of problems with brokers arises because the dislocation of the arrangement of a loan from its outcomes and implications does not facilitate or encourage responsible lending practices. This imbalance is exacerbated by the commission structure within which most brokers work, which encourages them to 'sell' as much credit as possible without the need to have regard for the consequences. We have noted, above, that the falsification of information and misrepresentation of the terms and conditions of agreements are both practices that are commonly associated with the involvement of brokers. These practices intensify existing problems of irresponsible lending and frustrate the attempts of more reputable lenders to act responsibly.

More specific problems include brokers failing to disclose the fact that they are tied to particular lenders and using brokerage agreements which allow them to charge fees even when clients do not enter into a credit agreement. The size of brokers fees, noted above, could also render an agreement extortionate. Fees are even more problematic when they are deducted from the advance, leaving borrowers with less than they thought they had borrowed, while still paying interest on the total amount.
Problems also occur with unsecured loans linked to the purchase of goods, where the loan is arranged by the retailer or supplier of the goods. The OFT has noted complaints about companies using agreements for the supply of goods which they claim are binding, even though they are linked to credit agreements which are cancellable. In addition, some home improvement companies have installed goods, such as a central heating system, during the cancellation period of the credit agreement in an attempt to prevent the borrower from cancelling.

Finally, there are, in some Asian communities, people known as 'go-betweens'. These are people who come from the community and help others to obtain credit because they can speak English and know their way around British financial service providers. The fees charged range from £200 to £500 and, at the reputable end of this market, the 'go-between' helps with writing letters, filling in forms and interpreting at meetings with high street lenders. At the less reputable end, there are strong indications that the go-between is selling on a loan taken out in his own name (Gildon, 1992; Herbert and Kempson, 1996).

Debt recovery

Debt recovery practices are not a problem at the reputable ends of either the alternative or the non-status market. It is among the less reputable lenders that the worst practices are to be found, including:

- immoral and illegal practices
- allowing financial penalites to erode the equity for secured loans

In the alternative market, unlicensed, and even some licensed, lenders engage in practices that at best are immoral and at worst illegal. Money advisers and trading standards officers told us of many instances of harassment and threats of violence as well as impersonation and force to gain entry to people's homes.

Unscrupulous non-status lenders, too, may harass borrowers to obtain payment. But particular concern has been expressed about the way that they deliberately lend to people they know will default and then let them build up substantial sums in financial penalties before moving for possession. Despite having adequate equity in their homes to cover the initial loan, borrowers who default may end up both homeless and without any capital once the debt has been repaid.

1.3 Summary

In identifying the particular lenders and lending practices that are generally associated with extortionate credit, we have attempted to provide an overview of two distinct markets – alternative and non-status lenders. It is, however, important to remember that no single type of lender can be directly associated with extortionate credit. Similarly, no single lending practice necessarily constitutes an extortionate agreement. Within each market there are both reputable and disreputable lenders, including some in the alternative market who are unlicensed. Equally, there are both good and bad practices, including some that at best might be considered extortionate and at worst are illegal or immoral. The most respectable lenders in each segment may have little in common with the least respectable.

What is clear, however, is that there is a cumulative effect whereby the most vulnerable consumers, who tend to present the highest risk to lenders, are more likely to be channelled towards the least respectable end of the market and are, therefore, subject to the most questionable lending practices.

2 Who uses alternative and non-status lenders and why?

There is clearly a minority of lenders whose lending practices would be considered extortionate, however that were defined. Some of these are unlicensed, but others are currently operating with a licence under the Consumer Credit Act. Equally, there are practices and loan terms that are widely viewed as extortionate but are deployed by a much larger number of more reputable lenders. This raises a number of key questions: Who uses such lenders? Why is there a market for extortionate credit? And what are the other options for people who use these lenders and why aren't they used?

In seeking to answer these questions we have adopted a wider perspective – on the alternative and non-status lending markets generally – and set the particularly problematic forms of lending within this framework. We have adopted this approach for two main reasons. First, as noted in Chapter 1, there are lending practices and loan terms that are considered extortionate within these wider markets. And secondly, it helps set in context the reasons why a minority of people use the more obviously extortionate forms of credit.

2.1 Who borrows from alternative and non-status lenders?

In the previous chapter we drew a distinction between 'alternative' lenders – moneylenders, pawnbrokers, cheque cashers and new companies like Cash Converters and Crazy George – and the non-status lenders, especially those offering secured loans. In fact, they lend to quite different groups of people, although the unifying characteristics of their borrowers are that they tend to have limited access to mainstream lenders, they often borrow to deal with financial problems and they have very little money even for essentials.

2.1.1 Users of alternative credit providers

It is hard to provide estimates of the size of the alternative credit market as reliable statistics are scarce and where figures are obtainable from the industry, they often do not tally with those provided by surveys.

For example, the Consumer Credit Association estimates that around 3 million people have loans from one of their members or another ***licensed moneylender***. This figure is based on estimations of the number of agents in the UK, the proportion of them working full-time and the number of loan accounts they would need to make a round financially viable. It also makes allowance for the fact that many customers use more than one company. On the other hand, surveys consistently put use of moneylenders at around 1-2 per cent of the population (or 450-900,000 people) (OFT Vulnerable Consumers Survey data; Berthoud and Kempson, 1992; OFT/PAS, 1987). There are at least three possible explanations for this discrepancy. First, it is clear that some people are reluctant to admit to using a moneylender – even a reputable one like Provident Financial. Secondly, some lenders, including key national companies, provide more than one loan to a client at a time and this is not allowed for in the CCA estimates of the total number of customers. Thirdly, many people buy goods on instalments, rather than taking cash loans and they may well categorise this as buying on hire purchase when questioned in surveys.

On the whole, loans from moneylenders are for small amounts over short periods of time. Most agreements are for either six or twelve months and the average advance is £100 to £200. New customers are granted small loans at the outset and, if they establish a good record of repayment, their credit limit is gradually increased. Many customers, however, prefer to remain with small loans that are manageable within their budget.

Survey data shows that about a third of credit obtained from moneylenders is used to pay bills or make ends meet. The rest is used to buy household goods. Linked to this is the finding that a third of borrowers thought, at the time that they took out the loan, that it would sometimes or always be difficult to find the money to repay it, although a half expected to be able to repay without any difficulty at all. Both the level of borrowing to meet other financial commitments and the level of anticipated repayment difficulty were appreciably higher than for maintream lenders (survey data collected for Berthoud and Kempson, 1992).

Qualitative research with customers of moneylenders similarly found that they were largely using cash loans to address problems of ongoing *'income inadequacy'* (Rowlingson, 1994). Two thirds had taken loans either to manage the ups and downs of their household budget or to pay specific household bills. This was especially so among the minority of customers who were pensioners.

Generally speaking, moneylenders are reluctant to take on very poor people as new customers, although they retain customers should they fall on hard times. As a consequence many of their customers are either not in employment or, if they are, it is low-paid. Most are tenants. They include people of all ages, but the need is greatest among families with children. The majority of customers are recruited by word of mouth, usually by family or close friends. Indeed, it is not at all unusual for a whole family to be borrowing from the same lender. Most people begin borrowing in this way when they have a particularly pressing need – for clothing, household essentials or to pay bills (Rowlingson, 1994). Their economic circumstances, coupled with a need for small loans for short periods of time do not make them attractive to the mainstream credit industry.

There are, however, some groups of people to whom even licensed moneylenders are reluctant to lend. These would include lone parents, the long-term unemployed, hostel dwellers and people living in high crime areas (Burrows, 1999; Rowlingson, 1994; Speak et al, 1995). These are the ones most prey to ***illegal or unlicensed moneylenders*.** It is just about impossible to provide a reliable estimate of the extent of illegal moneylending. However, in Glasgow alone, it is estimated that about 100 illegal moneylenders are at work at any one time. And each lender could have up to 50 customers. If all the major cities in the United Kingdom had a similar penetration, there could be over 60,000 people using illegal moneylenders at any one time.

They lend almost exclusively to people who need money to make ends meet, usually making weekly or fortnightly loans at very high rates of interest. Two lone mothers in Newcastle discussed the lenders they used:

> *'If I get short , I'll have to borrow, like… just a tenner one week and pay them back twenty next.'*
>
> *'Twenty! That's a lot! I only give them £15 for a tenner. Mind I don't know what it would be like if I couldn't pay it back, like.'*

All the evidence suggests that fewer people use ***pawnbrokers*** than borrow from a moneylender. Around 0.1% of the adult population (or around 50,000 people) admit to using a pawnbroker in the course of a year (OFT Vulnerable Consumers Survey data; Berthoud and Kempson, 1992; OFT/PAS, 1987). Once again this is likely to be an underestimate as there is much the same reluctance to admit to pawning as there is to using a moneylender. There are no industry estimates of the number of users of registered pawnbrokers, although the National Pawnbrokers Association estimate that there are around 800 shops in Britain. Extrapolating from research conducted in the United States (Johnson and Johnson, 1998) one arrives at an average figure of around 1,000 customers and 4,000 pledges per shop per year. If the level of use in the Britain were similar, this would give somewhere in the region of three quarters of a million users per year.

Most pawnbrokers have a very local clientele, with one large pawnbroker assessing that 90 per cent of his customers live within 2 miles of his shops. And many of their customers pledge the same item repeatedly; according to the same pawnbroker as much as 75 per cent of his business is the same people pledging the same items. Survey data from the United States shows that four fifths of customers had borrowed more than once in the last year; while almost four out of ten had had four or more loans. On average, customers had had four loans each. The majority of customers were long-term users of the same pawnbroker and had first identified it by noticing the sign while passing the shop. They were drawn disproportionately from people with low incomes, from ethnic minorities and from people renting their home. Like users of moneylenders, families with children were also over-represented (Johnson and Johnson, 1998). Although they are much the same types of people, qualitative research in Britain suggests that people either use a moneylender or they use a pawnbroker; they rarely do both (Kempson et al 1994).

Around half of US loans were taken out to meet other financial commitments – with about a third to being used pay pressing bills (Johnson and Johnson, 1998). The National Pawnbrokers Association estimates that a similar proportion of loans in Britain would be used to help make ends meet. In Britain, the average loan size is between £65 and £80, so the sums of money are smaller even than those offered by licensed moneylenders. The National Pawnbrokers Association also estimates that around a half of pledges are redeemed within a month; and three quarters within three months. One large pawnbroker told us that only 15 per cent of pledges with their company are not redeemed at all.

Agency mail order catalogues are used by 19 per cent of the adult population, that is about 8 million people. However, the great majority of these are people who either purchase through their own account (43 per cent), or are agents themselves (26 per cent). About a third of users buy items through an agent and so would not receive the agent's commission to offset the higher price of the goods sold on credit through mail order. This is equivalent to 2.75 million people (Kempson, 1997, supplemented by data from the OFT Vulnerable Consumers Survey).

Once again, these customers are very similar to those using moneylenders or pawnbrokers both in economic and in personal and family circumstances. In other words, there is a preponderance of people on low and low-middle incomes and use is heavily concenrtrated among families with children. There is, apparently, very little overlap between the customers of these three types of credit. Even among the lowest income group (households with net incomes of up to £100 a week) only 17 per cent of people using agency mail order said they were also using a moneylender or pawnbroker. Although, for the reasons given above, this will almost certainly be an underestimate (Kempson, 1997).

Agency mail order is largely used to buy essentials – clothing (78 per cent of users), household goods (40 per cent) and electrical goods (14 per cent) (Kempson, 1997).

Far less is known about the users of the newer forms of alternative credit. All that can be said with any confidence is that because many check cashers are also moneylenders or pawnbrokers, there is almost certainly an overlap between the types of people who use these organisations. Information obtained by the British Cheque Cashers Association from the United States, where cheque cashing has existed since the 1930s, would support this conclusion.

2.1.2 Users of non-status lenders

Data supplied from the NOP Financial Research Survey shows that that one per cent of adult the population has a loan (other than a mortgage or second mortgage) that is secured on their home. That is around 450,000 people. Of course, not all of these will be non-status loans, while, at the same time, there will be mortgages and second mortgages that are non-status. However, the characteristics of the people who have borrowed in this way may give some indication of the level of non-status non-mortgage lending. People in social class C1 are over-represented among secured borrowers and account for 41 per cent of all those with this type of loan. It is, however, the 43 per cent in social classes C2, D and E (and more especially the 19% in classes D and E) who are most likely to be non-status borrowers.

This same data shows that 91 per cent of all secured borrowers are aged between 25 and 54, with people of these ages being over-represented relative to their proportions in the adult population. Use is similarly concentrated among older families (30 per cent), older couples (26 per cent) and young families (20 per cent). It is disproportionately located in the South of England, where 47 per cent of people with secured loans live (compared with 31 per cent of the adult population). Secured borrowers are greatly under-represented relative to the population in London and in the Midlands[1].

Research undertaken by the National Consumer Council in 1987, found that 7 per cent of the adult population had either a second mortgage or a secured loan, 16 per cent of which were with a finance house rather than a bank or building society. (This is a similar level of secured loans as that currently identified by the NOP Financial Research Survey). The great majority of these loans had been taken out for the 'traditional purpose of home improvements or major house repairs or extensions'. But five per cent had been taken out to repay existing debts. This same study also identified people who had problems with secured loans through local advice agencies. Among these people there was a much higher level of use of the loan to consolidate other loans (30 per cent); or secure their overdraft or other personal loans (4 per cent) (NCC, 1987).

2.2 Why is there a market for extortionate credit in the UK?

The existence of an extortionate credit market is generally attributed to 'market failure' and the fact that competitive forces do not work effectively in the credit markets which cater for low-income and non-status households. While this is true for the less scrupulous end of the market it is not necessarily the case for the generality of alternative and non-status lenders. To understand why these credit markets exist, it is helpful to consider both demand and supply factors. At the same time, it is clear that consumers' lack of information plays a role.

2.2.1 Demand factors

The key context for the demand for both alternative and non-status lending is the rapid growth, over recent decades, in people's use of credit. In the 1990s, use of credit has become the norm rather than the exception that it was two decades ago. Credit has become so much a part of everyday life that income level is no longer a determinant of whether credit is used, but rather the type and source which is used.

In addition, growth of the ***non-status market*** was fuelled by the recession in the early 1990s, although it is not at all clear whether the alternative credit market was affected in the same

[1] We are very grateful to NOP Financial for providing us with this data.

way. Over the last decade, there has been a substantial increase in the numbers of people with poor credit records or a history of bad debt. An indication of the growing problem of indebtedness is the fact that between the beginning of 1990 and the end of 1998, 454,280 households had their home possessed as a result of mortgage arrears (Council of Mortgage Lenders). This compares with only 140,130 over the whole of the 1980s. This, however, is only the tip of the iceberg and is indicative of a high level of debt among home owners.. Over the period 1990-1998 more than 650,000 households were taken to court by their mortgage lenders (Lord Chancellors Department) and many more will have received county court judgements for other forms of debt. In 1998, alone, 1,188,282 new judgements were made, although this includes people against whom more than one judgement was entered (Registry Trust).

These high levels of bad debt have created demand for non-status lending in two quite distinct ways. First, they have created a market for secured loans to repay existing commitments – as described above. Secondly, they have resulted in a refinement of application and behavioural scoring as well as the development of geo-demographic databases for marketing, so that companies are now able to target screen the lowest risk/highest profit customers within their market. Consequently, there is a demand for credit among people with a history of bad debt that is not being met by mainstream creditors.

Demand for the ***alternative credit market*** is rather different. While it certainly includes people with a poor credit rating, much of the demand is for products that are not supplied by the mainstream credit market. In other words, it is for small sums of money borrowed over relatively short periods of time. Indeed, customers frequently mentioned this as a key advantage of borrowing from licensed moneylenders.

> *'The beauty of it is it's a short loan'*
>
> *'Anything we get we always pay over the top to get it finished. I don't want a longer term loan as it never seems to end'.*

Moreover, there are aspects to the services offered by alternative creditors that are directly designed to meet the circumstances and patterns of budgeting of people on low-incomes. Licensed moneylenders and mail order companies collect payments from customers' homes weekly. This not only fits with the normal budgeting cycle of most of their customers but also exerts subtle pressure for payments to be made.

> *'I like the way someone comes to the door. I don't have to remember constantly to send a cheque or something'*
>
> *'… she does knock on the door and you know she's coming and the money's got to be there, the interest rates are high but then everyone that uses [company] knows that anyway, so it's just convenience.'*

In addition to the convenience of payments, the total transparency of costs is appreciated by those who use moneylenders. As noted above, the APR and total charge that licensed moneylenders disclose to their customers when they take out a loan, includes an allowance for a certain level of missed payments for genuine reasons. So, although people know that they pay more, in the long run it enables them to retain some stability over their outgoings and may not actually work out much more expensive once default charges levied by other lenders are taken into account.

> *'…we had a bank loan a couple of years ago, now, and it was awful, and we were paying about ,80 a month it was, which is what we're paying now, but if we left it one month we used to get a letter and then they'd add another 25 quid onto that and*

> *interest on if you don't pay it and in the end you're paying double what you originally got. It was horrifying.'*
>
> *'As I say, you do pay a lot more interest on the [moneylending company] than you did with the bank, but … if you can't afford to pay you don't get the interest added on anyway, which you do for the bank, so...'*

Users of pawnbrokers are similarly attracted to the transparency of costs. While cheque cashers' charges are a good deal more transparent than those made by banks on unauthorised bank overdrafts.

The other chief advantage is the lack of bureaucracy involved in getting access to credit from alternative providers. This applies especially to mail order and pawnbrokers, but is also true for long-term customers of licensed moneylenders.

> *'You want a loan out, they just get a piece of paper, I just put my signature on the bottom, he does the rest and gives you the money there and then.'*
>
> *'...there's not a lot of palaver in getting the loans. It's easy to get a loan and pay it back without any hassle. There's not piles and piles of paperwork before you get an answer.'*

In other words, it is important to recognise that people use alternative credit sources for both positive and negative reasons. In contrast, use of non-status lenders is seldom through a positive choice.

2.2.2 Supply factors

One of the most basic rules of a competitive market is that where unmet need exists, new forms of supply will develop to meet it.

The ***alternative credit market*** has developed to meet the needs of low-income communities that cannot easily be met by mainstream lenders. There are few formal entry requirements to this credit market, which is characterised by a greater reliance on informal, non-bureaucratic methods of risk assessment, such as personal recommendation. Further, alternative providers have developed their own strategies for risk management and reduction. These include weekly collection through doorstep agents; the issuing by moneylenders of step-loans starting with very small or non-cash advances and moving up to larger amounts once credit worthiness has been established; and the requirement of security for a loan by pawnbrokers. New entrants, such as Cash Converters and Crazy George have devised methods that are variants on pawnbroking. In the first case, purchasing second hand goods but giving the seller the option to buy them back at a higher price within a set period of time. In the second, offering customers the option of paying for 'insurance cover' that allows them to return the goods to the warehouse during any periods that the repayments cannot be maintained.

The rapid growth of ***non-status lending*** in recent years is due, in no small part, to the growing numbers of people with poor credit records or a history of bad debt. Tightening of lending criteria by mainstream lenders has also fuelled the development of the non-status market. Non-status lenders compensate for the additional risk they bear in lending to these customers by higher interest rates or requiring a greater degree of security.

Compared with the non-status market, there is rather more competition in the alternative credit market. Consequently suppliers, particularly in the moneylending sector, pay particular attention to retaining customers and encouraging further borrowing. Like the mainstream revolving credit market, it is predicated on practices which involve *'careful manipulation of consumers into a decision to take credit and further manipulation of the amounts and terms of that credit' (ACA, 1988).* Companies' lending practices, described above, clearly illustrate the central role that the social relationships between agents and customers play in encouraging continued borrowing.

2.2.3 Lack of information

Lack of information is a potential problem for consumers in any market, not simply the credit industry and certainly not only for people without access to mainstream provision. Consumers of all types of credit are frequently not in a position to assess fully the agreement they are signing. Those with access to more than one source of credit can, at least, make comparisons between them and select the one that comes closest to meeting their needs. People with limited options, however, such as those who use lenders operating in the non-status or alternative markets, have few, if any, sources of comparison. They certainly have little to gain by comparing the costs and terms of the credit that is available to them with those for mainstream sources to which they cannot gain access.

When people are borrowing for discretionary or *'life enhancing'* reasons (OFT, 1991) this lack of information potentially has less impact, because they can choose not to borrow at all. Those borrowing to meet pressing needs, without other resources to draw on, frequently lack this choice and have little, if any, opportunity to shop around. Consequently, information imbalances are intensified by inequalities in bargaining power. It is the interaction between these two forces that provides the context for an extortionate credit market.

Costs

The main focus of the debate on consumers' ability to accurately assess the credit agreements they enter into usually centres on cost and, in particular, on the adequacy of the APR (Annual Percentage Rate) as a means of measuring, and comparing, the total cost of credit. APRs are intended to provide a standard that is applicable to all forms of credit. *'In other words, APR expresses the cost of all types of credit in a common mathematical language which can be understood and used by all'* (OFT, 1990).

Most mainstream credit providers argue that, although not perfect, the APR system is a relatively effective comparator of the costs of credit. Yet others, including consumer groups, researchers and credit providers operating in the alternative credit market, argue that reliance on APRs is highly problematic. A number of reasons have been put forward for this point of view.

First, consumer understanding of APRs is generally low. Money advisers report confusion or misinterpretation of the system, although the Office of Fair Trading suggests that this viewpoint maybe overly pessimistic. Survey research commissioned by the OFT found that although less than half of the people questioned were able to state correctly what the letters APR stood for, around two thirds had a broad understanding of its meaning (OFT, 1994). However, the fact remains that the vast majority of these simply knew that APRs were an indication of the interest charged – a fairly limited interpretation. Just one in ten were able to identify the exact definition from a list of four possible options. In addition, only two fifths of people who had used credit in the five years prior to the survey said that they had considered APRs as part of decision-making. Despite misgivings about consumers' understanding of APRs, the OFT has noted *'general agreement'* that they remain useful as most can recognise that a higher APR indicates higher costs (OFT, 1994).

Secondly, there is doubt whether APRs are, in fact, comparable across all types of credit. Particular problems are associated with comparing APRs for mainstream credit with those provided by alternative lenders who offer small loans over short periods of time. The mathematical formula for APRs can considerably distort the apparent costs of credit involving short repayment periods, particularly agreements of less than 12 months, and small amounts of money. As the OFT has noted:

> *Indeed, for certain credit agreements, notably those where the amount borrowed is small and the repayment period quite short, information about cash-flows is considerably more relevant than an annualised statistic such as APR, which can, in such circumstances, be genuinely misleading. (OFT, 1994, pp.69)*

In addition, lenders do not necessarily include the same range of charges within their APR. The exclusion of some items, such as protection insurance, and some types of credit, such as overdrafts, from the APRs of mainstream credit providers has been described as *'completely arbitrary'* (CCA, 1992).

Calculating meaningful APRs is also a particular problem on running account credit, compared with loans that have fixed repayment terms.

Even leaving these flaws aside, however, the fundamental question remains of whether interest rates of any kind are meaningful to consumers, particularly those who are most vulnerable. Recent research by the National Federation for Educational Research found high levels of difficulty dealing with both percentages and interest rates. For example, only 52 per cent of lone parents were aware that 10 per cent of £300 is more than £25 and only a minority of people understood the meaning of gross and net interest. (Schagen and Lines, 1996). Interviews with customers of moneylenders confirm this finding; few of them understood what interest rate means, as the following quotations show.

> *'I could go out and get a loan really, I could go out and get a loan from someone else, I could borrow ,200 and only have to pay ,25 back on top of it. It's only 25%.'*
>
> *'If you can have an ,80 loan over 34 weeks and pay ,124 back, that's 44% interest rate, which is an awful lot of money.'*
>
> *'It worked out on ,100, he called round for 12 weeks and it was 20% interest. It was ,10 a week for 12 weeks.'*

The recurrent theme from these interviews is that, where people believe they know the interest *rate*, they simply quote the *amount* of interest they have to pay. Indeed, this is the yardstick by which they judge the costs of credit; a loan is considered cheaper if the total amount paid in interest is lower. As a consequence, they see short loans as better value for money than longer ones even though the APR is higher.

In addition, consumer representatives, regulators and academic commentators have all noted the limited relevance of the total cost of credit to low-income households in comparison with factors such as accessibility and manageability. Again this is borne out by the interviews with customers of moneylenders.

> *'I mean everyone knows that their interest rates are higher than the average, but I'd rather go to them than go to someone out of the paper that you don't know.'*
>
> *R1 ' That is high, ,50 is high.'*
> *R2 'It probably is to you, but it's convenient for me.'*

Terms and conditions

Despite the emphasis on APRs, it is not just the cost of credit that consumers need to be aware of. The terms and conditions of credit can be far more important than simply the price – especially at the less reputable end of the non-status credit market. Yet consumer knowledge in this area is, if anything, even more limited than their knowledge of costs. Added to which, there is no equivalent of the APR to help consumers compare the terms and conditions of loans.

Research conducted among borrowers in difficulty with secured loans found that about half of them had no idea that they were risking losing their homes if they defaulted on their loan (NCC, 1987). Since that research, regulations have been introduced requiring all such loans to carry a health warning, although the OFT is of the view that consumers have ceased to take notice of these warnings.

At the unscrupulous end of the non-status secured loan market, where discounted interest rates are used, we were told of cases where lenders and brokers tell consumers not to be concerned about the discretionary interest clause as it does not apply to them. Consumers who are most desperate to get a loan seldom read the agreements they are signing and may even be told that they are entirely straightforward.

2.3 What other options are available and why aren't they used?

Almost by definition, people who borrow from the alternative or non-status credit markets have limited access to mainstream credit. But there the similarities between the credit options open to these two groups ends.

2.3.1 Users of the alternative credit market

Relatively few users of the alternative credit market have had applications turned down by mainstream lenders. More often, they second guess the results of credit scoring and do not even apply in the first place. Or they have used other forms of credit in the past, but ceased doing so following a big drop in income (Kempson et al, 1994; Rowlingson, 1994).

Users of alternative credit providers do, never-the-less, have a degree of choice, albeit outside the mainstream credit market. Two research studies have attempted to segment the credit market. The first was a quantitative study that grouped credit sources according to the median income level of their borrowers. This identified a 'down-market', which included moneylenders (including those offering doorstep retail credit) and pawnbrokers, along with the government's Social Fund and loans from friends and relatives. Interestingly, credit unions were included in the mid-market as their members with loans had incomes that were almost double those of moneylenders' customers (Berthoud and Kempson, 1992).

Subsequent qualitative research was designed to explore the credit options open to low-income families with children - who are the heaviest users of 'down-market' credit. This found that there was almost no overlap in use of mainstream and alternative credit providers. As already noted, these two sectors of the credit market offer rather different products, with alternative providers tailoring theirs to the budgeting needs of those on low incomes. It was equally clear that people were making choices between the range of alternative credit sources that they had ready access to. So, for example, it was rare for someone to buy goods from doorstep lenders *and* to be buying them from an agency mail order catalogue. They generally preferred one source or the other. Likewise, people either sought cash loans from moneylenders or they used a pawnbroker; they rarely used both (Kempson et al, 1994; Kempson, 1997; Rowlingson, 1994).

Turning now to the non-commercial options, reciprocal borrowing from friends and family was widespread, went hand-in-hand with using alternative credit providers and generally involved small sums of money to tide them over from one week to the (Kempson et al, 1994). In contrast, obtaining a budgeting loan from the Social Fund was far more problematic. Until the recent changes to the Social Fund, budgeting loans were only granted for specific purposes – buying beds or cookers, for example. A number of studies have shown that people found it hard to obtain a loan for most of the reasons they needed to borrow money – to make ends meet, pay bills or buy articles of clothing (Huby and Dix, 1992; Kempson et al, 1994). As a consequence those in the know tended to lie about the purpose of the loan.

> *'We just put £70 towards debts – TV licence, gas, electricity – that's out of the loan that's supposed to be for the house'*
>
> *'You have to tell a little lie… I needed to get clothes for the boys and put that on my list, but they wouldn't give it to us, so I said I wanted bedding… and I got the money for that and then bought what I really needed'*

(Kempson et al, 1994).

In fact, there was a high degree of overlap between the types of people using moneylenders or pawnbrokers and those borrowing from the Social Fund, suggesting that, in its revised form, it could really begin to act as a competitor to the alternative lenders. Several factors will, however, limit its role as a competitor. First, Social Fund budgeting loans are only available to people claiming Income Support; secondly the fund is cash limited, and thirdly knowledge of the Fund is by no means universal among claimants. Indeed, lack of information was found to be one of the main reasons explaining why some people do not apply to the Social Fund, while others, in similar circumstances do (Huby and Whyley, 1994). Ethnic minorities, pensioners and some lone parents have all been identified as having low levels of knowledge (Herbert and Kempson, 1996; Kempson et al, 1994; Rowlingson, 1994).

An important question is why there is so little overlap between the alternative credit market and credit unions. Certainly, credit unions are still fairly thin on the ground and that would explain the low levels of use generally, but not their apparent lack of general penetration into low income communities.[2] Two research studies have deliberately included areas in which there was a credit union in operation and these provide some explanations. In fact, relatively few of the people interviewed were even aware that they had a credit union in their area and had no idea how one would work. There were four main reasons why people who did know about their local credit union chose not to use it. Some were suspicious of anything run by local people and preferred to deal with an established company. Some were concerned about their neighbours knowing how much they were borrowing and preferred the privacy of dealing with a moneylender in their own home. Some had an incorrect idea of how a credit union works, as the following quote illustrates:

> *'From what I can gather, if we went into it we could, say, pay them £10 a week for 10 weeks. On the tenth week they'd give us a loan of £100 . And it's only our money that we've paid in anyway… But instead of paying £140 back [the rate he pays his moneylender], you only pay £110 or £120… So the way I look on it is, if I've paid £100 in already, and I'm getting £100 back out, which is my money anyway, I might*

[2] There are some notable exceptions, but on the whole, community-based credit unions in low-income communities tend still to be fairly small.

as well have a bank account because I'm paying [the credit union] £20 interest on my £100.'

Others were simply unable to save, especially if they were already using other high cost forms of credit (Kempson et al, 1994; Kempson, 1998; Rowlingson, 1994).

So far, we have concentrated on the reputable end of the alternative credit market and the picture is altogether different among those who use unlicensed moneylenders. For the most part, these are people who have no-one at all to turn to for a small cash loan. They have nothing to pawn, live in hostels or neighbourhoods where licensed moneylenders will not do business and have no relatives or friends they can turn to. Indeed, many people using unlicensed moneylenders use them for much the same reasons as others set up reciprocal arrangements with family or friends – for small sums to help them through to the next benefit cheque. The only other option potentially open to them is the Social Fund (Burrows, 1999; Herbert and Kempson, 1996; Kempson, 1996).

2.3.2 Users of non-status lenders

For the most part there are few other credit options for someone who is considering borrowing from a non-status lender, especially if they are taking out a secured loan to meet other financial commitments. By definition they would be most unlikely to get a loan from a mainstream lender, and the sums of money they require could not be provided by lenders in the alternative credit market.

A consideration that is often omitted from the debate, is the widespread lack of awareness of the alternatives to borrowing. Much research and literature indicates the pressing nature of the needs to which many such borrowers are responding. Yet it is questionable whether a consolidation loan is the best course of action for those borrowing to ease financial difficulties and repay existing debts. In such cases, the more suitable option is to seek advice and help with negotiating with creditors.

Few people appear to be aware that they can contact their creditors and make arrangements to repay their debts. Recent research has found startlingly low awareness of free money advice services (Whyley and Collard, forthcoming). This largely arises because free money advice services are so under-resourced that they are unable to advertise their services or they would be overwhelmed by demand they could not meet. As a result, a growing number of private debt advice companies are being set up. Because these companies charge a fee for negotiating with creditors, they are able to advertise their services since an increased demand means increased profits. Typically their advertisements are to be found among those for non-status debt consolidation loans in the tabloid press. Both the morality of charging people who are already in debt a fee for advice, and the quality of the service provided by some of these agencies has been questioned. But using a fee-charging debt advice company to manage repayments to a range of creditors is almost certainly preferable to running the risk of defaulting on a secured loan.

2.4 Summary

Only a relatively small number of people use lenders who offer credit agreements that would be considered extortionate in most people's eyes – possibly no more than a hundred thousand people at any one time. But there are many more (indeed millions) who borrow in the alternative and non-status markets and are potentially at risk of extortionate terms on their loans. Consequently, the terms and conditions attached to credit from some lenders present a bigger problem in relation to extortionate credit than interest rates alone. This is exacerbated by the fact that terms and conditions are less transparent than the cost of a loan.

Users of the alternative market tend to live on low incomes, to rent their home and to be families with dependent children. The most vulnerable of them are borrowing to make ends meet or to pay bills. By and large their credit needs – for relatively small sums for relatively short periods – cannot easily be met within the mainstream credit market, even if they would pass the credit scoring to gain access. As a consequence, a market of alternative providers has grown over the years that caters specifically to their needs and many people are attracted to this market for that reason. However, demand for this market is triggered by positive, as well as negative, factors.

People who use such providers often have a poor understanding of the costs and terms of the credit they are taking. They do, however, usually have a range of different types of alternative provider from which they can select and most have their preferred source. They also have non-commercial options open to them, including borrowing from family and friends and applying for a Social Fund Loan, although these are limited in the sums of money they can lend. For a variety of reasons, credit unions have yet to make a significant impact at this end of the credit market, although there are some notable exceptions. People who borrow from either unlicensed lenders or the less reputable licensed ones are normally in financial difficulty, have no access to the reputable end of the alternative credit market, and have no friends or family to turn to for short term loans. They include lone mothers on benefit, the long-term unemployed, people living in areas of high crime, some ethnic minorities and hostel dwellers.

Users of non-status loans, by definition, have no access to mainstream credit because they have poor credit records or a history of bad debt. Since much of this market is for secured loans they are more likely to be home owners than tenants. Again, the most vulnerable of them borrow because they face financial difficulties – but in this case it is usually to pay off existing commitments that have become unmanageable. In contrast to the alternative credit users, their needs are for large loans on terms that would normally be provided by the mainstream credit industry. People in this position, usually have no other option for borrowing money and often take out agreements they have not read properly, if at all. A more appropriate solution to their problem almost certainly lies, not in borrowing, but in seeking help to negotiate manageable repayment plans with their creditors. The people who borrow from the least reputable non-status lenders are usually in serious financial difficulty, have at least one county court judgement and cannot obtain credit from the more reputable end of the market. Lack of awareness of the availability of money advice and resource constraints on the free debt advice sector limit their use of the more appropriate solution to their problems.

3 Improving consumer protection

In seeking ways of tackling the problem of extortionate credit, we have first assessed the provisions of the *Consumer Credit Act 1974* and its ancillary regulations. But not all the difficulties lie in the legislation. Some relate to the enforcement process and to the penalties that can be imposed for malpractice. Equally, it is clear that some potential solutions lie entirely outside the processes of law.

Before considering each of these areas in turn it is, perhaps, appropriate to restate the scale and nature of the problem. On the whole, the problems that we have identified relate to the practices of a small number of lenders; some of which operate in the alternative credit market, others in the non-status loan market. These are summarised in Figure 1. From this we can see that far more of the concerns relate to the non-status lenders and, in particular, to those who offer debt consolidation loans secured on people's homes.

3.1 The effectiveness of current legislation

The Consumer Credit Act (s137-140) defines a credit bargain as extortionate if it requires the debtor or a relative to make payments that are 'grossly exorbitant' or it otherwise contravenes the 'ordinary principles of fair trading'.

Cases must be brought by the debtor, or their surety, and only a court can say whether any particular agreement is extortionate. The general factors that can be taken into account are: the prevailing interest rates when the credit bargain was made; any linked transactions and whether or not a colourable cash price[3] was quoted for any goods or services included in the bargain. Those relating to the borrower include: the degree and nature of financial pressure the borrower was under at that time the loan was taken out; and the borrower's age, experience, business capacity and state of health. Against this, the court can also take into account the risk accepted by the lender, in relation to the value of any security required for the loan.

Under Section 171(7) the responsibility for proving that the agreement is not extortionate rests with the creditor, but the person making the allegation must produce enough evidence to support their case. Section 139 of the Act permits the courts to re-open an extortionate credit agreement. There are no other sanctions.

In addition, two specific sets of regulations under the Act are relevant to a discussion of extortionate credit agreements. These are the Consumer Credit (Total Charge for Credit) Regulations, 1980, which set down what additional costs should be included in the APR calculation; and the Consumer Credit (Rebate on Early Settlement) Regulations 1983, which sets down the requirements regarding rebates payable if an agreement is settled early.

On the whole, it is widely believed, outside the industry itself,that *'the provisions of the Act have not effectively dealt with the problem to which they were addressed'* (OFT, 1991, pp.3). This view is predicated, primarily, on the fact that they have not been widely used.

[3] This term applies where the price of a product can be increased or 'marked up' in order to cover the costs of credit.

Figure 3.1 Summary of key concerns identified in Chapter 1

Advertising, marketing and selling practices
- Advertisements for secured non-status loans (A/N)
- Canvassing and ways round the law (A/N)

- High pressure sales (A/N)
- Selling in the home (A/N)

- Equity lending (N)
- Not checking income/ability to pay or falsifying income (N)
- Encouragement to borrow more than they want esp sums that take agreement outside CCA regulation (N)
- Encouragement to consolidate so have the first charge on the property (N)
- roll over loans (A)

Costs
- level (A/N)
- transparency (A/N)
- other charges (N)
- linked protection insurance and similar products (A/N)
- colourable goods (A)[4]

Terms and conditions
- rule of 78 and early settlement
  - roll-over and top-up loans (A)
  - long-term secured loans (N)
  - failure to settle superceded agreements within a reasonable time period (N)
- incomplete documentation (N)
  - lack of information on cancellation rights (N)
  - no copy of agreement (N)

Brokers and other third parties
- irresponsible selling (N)
- failure to disclose ties to lenders (N)
- non-disclosure of brokerage fees (N)
- deducting fees from advance (N)

- retailers/suppliers
  - linkage of consumer credit agreements to sale of goods agreements, which retailers claim are binding (N)
  - installation of goods during cancellation period (N)

Debt recovery
- discounted interest rates (N)
- harassment (A/N)
- threats of violence (A/N)

Unlicensed activities
- lending
- brokers (go-betweens)

Note: 'A' applies to some suppliers in the alternative credit market
'N' applies to some suppliers in the non-status credit market

[4] The term 'colourable goods' applies to goods for which prices are increased or 'marked up' in order to cover the costs of providing credit.

In contrast, some representatives of the credit industry believe that the current legislation is effective. This view is held particularly, although not exclusively, by those working in the alternative credit market. It has been argued that the limited use of the provisions of the Act indicates that the preventative elements of the legislation have been successful and that *'the low use of the current provisions indicates that there are on – or very few – extortionate credit bargains'*. (OFT, 1991, pp.17).

There do, however, appear to be three main problems with the existing legislation:

- very few cases are brought to court because the onus is on the borrower to initiate proceedings;
- the wording of the Act is too imprecise and judicial decisions have tended to be based on a restrictive interpretation of its provisions
- the penalties set down in the Act are inadequate.
-

To some extent, these are inter-linked and the relationship between them can exacerbate problems with the extortionate credit provisions. Each of these is considered in turn, with suggestions for improving the current legislation.

3.1.1 Number of cases reaching the courts

The OFT, in its analysis of extortionate credit cases could only identify 23 in total between 1977, when the provisions were implemented, and 1989. Fifteen of these involved a decision on whether or not an agreement constituted extortionate credit. Our own searches indicate that the level of cases reaching the courts has not increased since 1989. Moreover, most of these cases have arisen in the course of a hearing initiated by the creditor for debt recovery.

These figures almost certainly underestimate the number of times the provisions of the Act have been used, for three main reasons. First, the OFT's search was limited to one legal database LEXIS which does not cover all reported cases. Secondly, not all court cases are, in fact, reported – only those that set precedents or affect case law. Despite these caveats, though, it is doubtful that large numbers of cases are reaching the courts.

Finally, many cases, and usually those which look most likely to be successful, never make it to court as credit companies prefer to settle outside the court to avoid an agreement being found to be extortionate with the attendant risk of losing their licence.

Most commentators are agreed that the key obstacle preventing cases being taken to court is the fact that the responsibility for initiating proceedings lies with the borrower (or their surety). In reality, very few consumers are aware of the legislation that exists to protect them and even fewer know where to turn should they require redress. Further, as we saw in Chapter 2, while people may be aware that the credit they are using is expensive, they would be less certain that it is extortionate in the legal sense. Consequently, unless they come into contact with a lawyer or debt advice worker they will be unaware that they could get the agreement re-opened and the terms altered.

More importantly, however, even once they become, or are made, aware that they could seek redress through the courts, most consumers, and particularly those who are vulnerable, face significant barriers in taking a case to court. They are extremely unlikely to have the financial resources necessary to pursue a legal case. Unless they qualify for legal aid, the costs of bringing a case to court are extremely likely to be prohibitive.

In addition, borrowers may also face other practical, psychological and cultural barriers to bringing court action. Many will be unwilling to subject themselves to going to court and the formality of legal proceedings is likely to be alien to many of the most vulnerable borrowers. This group will be easily intimidated by the idea of going to court. At the extreme, borrowers dealing with the least scrupulous lenders fear intimidation or actual physical attack.

Finally, people with very limited access to credit are, naturally, extremely reluctant to take action or even give evidence against a creditor who is prepared to lend to them, in case they should need to borrow from them again in the future.

Each of these factors is aggravated by the difficulty of assessing the chances of success. Uncertainty about the likely outcome will significantly undermine a borrower's willingness to engage with the legal process.

One solution to this difficulty would be to allow a third party, such as a debt advice agency, a trading standards department, or the OFT to bring cases. This, in effect, is what happens in the United States, where such third parties can initiate a class action. A preliminary review of the situation elsewhere in Europe shows that, as Britain, the responsibility for bringing a case to court lies with the borrower (Reifner and Ford, 1992).

3.1.2 The wording of the extortionate credit provisions of the Act

A number of commentators remarked on the imprecise wording of Section 138 of the Act, which makes it difficult for district judges to use the Act effectively and consistently.

These problems are exacerbated by the small number of cases reaching court, as this means that judges have few, if any, opportunities to familiarise themselves with the legislation and very little existing case law on which to draw. A district judge interviewed for this study remarked:

> *'Firstly we don't have the knowledge. Secondly, we aren't well versed in the Consumer Credit Act as it's just a small part of our work… We are not equipped to deal with interest rates, we don't have the information at our fingertips. Generally speaking we tend not to take a proactive role, through lack of knowledge. That's the honest answer.'*

This is made even more problematic by the fact that such cases tend to be listed at the rate of six cases per half hour. This leaves district judges with very little time to assimilate the facts of a case before entering judgement, and certainly not enough time to consider the terms of credit agreements that are the subject of debt recovery hearings.

An analysis of the court cases indicates a degree of confusion over the precise meaning of the terms 'grossly exorbitant' (which replaced the 48% interest rate ceiling which applied in the old Moneylenders Acts) and 'fair dealing'. Further, broadening the provisions to include procedural factors, seems to have had little effect on the ways that judges make decisions about extortionate credit.

There are three main consequences of this. First, it means that, in most cases, judges have employed very restrictive interpretations of the provisions of the Act, relying on substantive rather than procedural factors. Secondly, there is evidence of inconsistency in these interpretations. Thirdly, while the Consumer Credit Act was intended to make it easier for consumers to seek redress for extortionate credit bargains, it has resulted in greater leniency for lenders.

Court cases show that while some judges have interpreted the new provisions as being as harsh as the previous test, others feel that the new test is even more harsh and, consequently more difficult to prove. Because they are uncertain about how to make use of the provisions, judges have seemed reluctant to be 'too interventionist' (Bentley and Howells,1989) particularly in relation to agreements which individuals have entered into of their own free will. Consequently, they have only been prepared to intervene in very clear-cut cases.

This has meant, an over-reliance on substantive factors, with a particular concern about interest rates, and an unwillingness to re-open agreements on procedural grounds. Consequently, some of the factors which the courts were intended to take into account, such as the borrower's personal characteristics; the financial pressure s/he was under at the time they made the agreement; and the relationship between the lender and borrower, have carried very little weight.

There has also been inconsistency about what should serve as the benchmark for 'prevailing interest rates'. District judges are clearly unsure whether this should be interpreted as the rates which are prevailing among similar lenders for similar types of credit, or whether it refers to the interest rates charged by mainstream providers. In either case, they lack the information they would need to make a decision.

In contrast to the limited use of borrower-related factors, those relating to creditors have been applied rather more often in reaching judgements. The level of risk that lenders have accepted in lending to some individuals has been afforded '*considerable importance'* (Bentley and Howells, 1989). Similarly, the term over which credit has been lent has also formed the basis of rulings, with shorter loans deemed to justify higher rates of interest. Further, variable rate loans, whereby lenders risk losing out financially if the interest rate drops below the level at which the agreement was made, have also been judged to legitimate higher rates of interest than might otherwise apply.

These problem areas are of key importance in their own right. In combination, however, they create a vicious circle. The difficulties which judges have in using the provisions have resulted in restrictive interpretations of their meaning, which has, in turn, made it difficult for cases of extortionate credit to be proven. This uncertainty over the likelihood of success acts as a deterrent to borrowers who might otherwise be persuaded to bring cases to court. The absence of cases means that there is very little case law to set precedents and make the legislation easier for judges to apply.

In their report *Unjust Credit Transactions* the Office of Fair Trading identified a need for some tightening of the wording of the Consumer Credit Act. In particular they recommended replacing the term 'extortionate credit' with 'unjust credit transaction'. Credit transactions would be considered unjust if they involve 'grossly excessive' payments or 'unfair or oppressive business activities'. It was also proposed that the court should have the power to reopen both defended and undefended cases. The OFT has recently re-stated its support for these proposals.

It has, however, been argued that these recommendations do not go far enough and, in the sections below, we consider other suggestions for improving the Act and experiences of other countries in implementing similar suggestions.

Controlling charges

In many other European countries[5], and many individual states in the US, there are interest ceilings, just as there were in the old Moneylenders Act. And many consumer organisations

[5] Including France, Netherlands, Belgium, Switzerland (OFT, 1991; Reifner and Ford , 1992, updated by interview).

would argue that there is a need for such ceilings in the current Consumer Credit Act. Experience elsewhere suggests that this may not, however, achieve the intended results and that there are three consequences of interest rate ceilings. First, interest rates tend to creep up to the ceiling. This is a particular problem when ceiling rates are deliberately not set too low.

Secondly, they tend to displace costs so that lenders can avoid including them in the APR. So the extent of colourable goods sold on credit tends to increase (Credit Research Center, 1980). And pawnbrokers tend to lend smaller amounts against the value of the goods pledged (Johnson and Johnson, 1998).

Thirdly, they tend to displace markets. Experience in the United States showed that when Massachusetts introduced a ceiling, the number of small loans ($500 dollars or less) decreased by a third, while the number of secured loans increased. On the whole it was the high-risk customers who were most adversely affected, and many were 'protected out' of the credit market (Caskey, 1991; Credit Research Center, 1980; Staten and Johnson, 1993). To mitigate these effects, many European countries have social lending schemes. The same would, almost certainly, be needed in the UK if interest ceilings were introduced.

An alternative approach would be to set presumptive interest rates – with lenders being free to charge higher rates provided that they can justify doing so. It has also been argued, on a number of occasions, that there is a need for guidelines on interest rates. These could be used by both by consumers, to determine whether they are being charged too much for their credit, and by judges to determine whether an interest rate is extortionate within the terms of the Act. The counter argument to such guidelines is that they would be complex and costly to compile and would need constant updating. A similar process is, however, used by the French government to determine interest rate ceilings.

A related problem is the current lack of transparency of the costs of credit. In theory, the APR should achieve this, but the various exemptions (for example, overdrafts, small loans), the ability of some lenders to displace costs and the problem that arises with colourable goods make it almost impossible for consumers (and judges) to compare the costs of borrowing from different sources. There is clearly a need to review the regulations in this area to achieve greater transparency.

Terms and conditions of loans

As noted above, consumer credit court cases seldom cover aspects other than the interest rate. Yet some of the worst examples of extortionate credit relate to other terms and conditions of loans, with particular concern being expressed about non-status secured lending.

The main area of concern relates to equity lending, where creditors are more interested in the security a borrower can offer than they are in the borrower's ability to meet the loan repayments. A similar problem exists in the United States (indeed, several of the non-status lenders in the UK are American companies) and the Federal Home Ownership and Equity Protection Act was introduced in 1994. This places special provisions on 'high-rate, high-fee mortgages', requiring them to consider the borrower's current and expected income, any outstanding obligations, and employment status when lending against their home. In 1995, this Act was included in the Truth in Lending Act. British debt advisers would like to see the law go further and have argued for judges to be given the power to reject an application for possession unless the lender can prove that adequate steps were taken to check the borrower's ability to pay. There is a particularly strong case to be made for this if the lender is aware that the borrower has a county court judgement or is seeking a loan to consolidate other debts.

Recent court cases have also raised a number of questions about the terms and conditions of some non-status secured loans – especially the use of discounted interest rates and other penalties following default. Again a similar problem exists in the United States and, in

Massachusetts, changes were made to the Massachusetts General Law to tighten controls on the companies most responsible for the abuse.

Finally, there is clearly a problem in relation to some brokers who deal mainly in secured loans for people with a history of bad debt and especially so where there is no clear separation of the broker and lender. Once again this problem exists in the United States and the Massachusetts General Law was revised to curb the types of practice we have identified in Chapter 1 and summarised in Figure 1, above.

In the UK, the OFT response to these practices has been to issue guidelines for non-status lenders. These have been criticised by the Finance and Leasing Association on two counts. First, they say that the definition of non-status lending is too broad and imprecise, and lenders are left unsure whether they have to take account of the guidelines or not. Secondly, they say that they are so detailed they are hard for a lender to implement. Whatever the merits of these arguments, the guidelines do provide a full statement of the problems that can arise in this market and useful indications of how these should be prevented. Equally, though, it is clear from the analysis in Chapter 1 and 2 that the worst practices tend to arise in a very specific market – that of secured loans to people with a known history of bad debt. In view of this, it could be appropriate to review the experience of the legislation in the US and see whether a similar approach would be appropriate in the UK. In addition, when the guidelines are re-issued the definition of non-status lender might be made more specific.

The final issue of concern to the OFT, trading standards officers and debt advisers is the use of the Rule of 78 to calculate early settlement rebates. In particular, as noted in Chapter 1, both the OFT and the courts (Falco Finance Ltd v Michael Gough) have found against its use for long-term secured loans. In addition, the use of Rule of 78 encourages the marketing of roll-over loans by some moneylenders. The OFT *Consumer Credit Deregulation report* and its guidelines on non-status lending suggest that it *'should be replaced by a ceiling on the amount of any fee that could be charged, possibly of the order of £100'*. In the United States, this problem has been tackled more directly. In 1992, Congress took the first step and required lenders to use the actuarial method to calculate rebates for loans of 61 months or more. The Home and Equity Protection Act took things further and defined use of the Rule as a prepayment penalty, which is forbidden under the Act, regardless of the loan term. Again, it could be appropriate to review the OFT guidelines in the light of legislative experience in the United States.

3.1.3 Penalties

A number of the people interviewed said that they thought the penalties for lenders who contravene the terms of the Act are too lenient. The only sanction open to district judges is to re-open the credit agreement. And in the few cases that have come to court, they have usually only substituted a lower rate of interest.

Other criticisms are that judgements only apply to a single credit agreement, not to other similar ones that the lender may have issued; nor does the Act deal adequately with repeat offenders. In its report *Unjust Credit Transactions*, the Office of Fair Trading suggested that *'section 166 of the Act be amended to include a requirement for the court to notify the Director General of cases where they have re-opened an individual credit bargain on the grounds that it is unjust'*. This could be used by the OFT to revoke the credit licences of lenders who continuously offend.

In addition, trading standards officers believe that the Act has inadequate provisions for unlicensed lending. All cases are treated the same, regardless of the lending practices as, by definition, these come outside the terms of the Act. And the penalties for trading without a licence are considered too lenient for most of the practices such lenders indulge in. During 1997, for example, there were 22 prosecutions for unlicensed lending. Of these, four resulted in a prison sentence, six in a conditional discharge; most defendents, however, were fined. Fines averaged less than £1,000, while amount awarded in compensation was a mere £50. In the experience of Glasgow and the old Strathclyde trading standards officers, the majority of those who have been convicted return to lending again. Even people who have been sent to prison have found someone else to run their business while they are out of circulation. As the OFT noted in 1991, there is a need for tougher penalties than exist at present.

Table 3.1 Consumer complaints reported by trading standards departments and advice agencies, in the 12 months to 30 September 1997

	Unsecured	First mortgage	Other secured credit	Ancillary credit Business	Total
Type of case					
Sub-standard service	953	260	185	626	***2,024***
Non-delivery	197	79	49	180	***505***
Selling techniques	2,676	484	377	1,326	***4,863***
Diffs correcting faults	231	60	34	101	***426***
Credit practices	6,809	630	693	1,918	***10,050***
Unfair terms and conditions	281	87	70	116	***554***
Price complaints	232	56	35	57	***380***
Health and safety	16	4	1	9	***30***
Mail order or prepayments	3	22	1	0	***26***
Total 1997	***11,417***	***1,661***	***1,444***	***4,349***	***18,871***
Total 1996	***11,573***	***1,560***	***1,331***	***4,838***	***19,302***

Source Office of fair Trading Annual Report, 1997. OFT 1998

3.2 The enforcement process

In 1997, local trading standards departments, advice agencies and other local bodies notified the OFT of 18,871 consumer complaints relating to consumer credit. A disproportionate number of these involved secured credit other than first mortgages. The great majority of these complaints were coded as involving ‘selling techniques’ or ‘credit practices’. Only 380 were coded as being specifically about price and 554 about terms and conditions, although others may well have been included in the more general ‘credit practices’ category. A disproportionate number of the cases regarding the price or terms and conditions of the loan related to secured loans (Table 3.1) (OFT, 1998).

In contrast, there were just 78 prosecutions under the Act. Three categories of offence accounted for most of these: 23 related to issuing or providing false or misleading information; 22 to unlicensed trading; and 14 to breaches of Consumer Credit (Advertisement) Regulations, 1989. In addition, as noted above, there will have been a handful of cases where the terms of the agreement were re-opened as being extortionate.

The interviews we conducted suggested that there are shortcomings at all levels in the in the processes of enforcement. First, there are difficulties persuading borrowers to co-operate either with applying for an extortionate agreement to be reopened by the courts, or with providing evidence that can be used to prosecute lenders who are unlicensed or contravene other terms of the Act. As noted above, this could be overcome, in part, if the Act were amended to allow trading standards officers to initiate proceedings on extortionate credit agreements.

Secondly, trading standards departments lack the resources to investigate abuses of the Act. Only a minority of local authorities, for example, have staff who are assigned specifically to investigate unlicensed trading and most struggle to collect the level of evidence needed for a credit licence to be revoked. More resources would almost certainly be required if they were given the additional powers to bring cases of extortionate credit to court.

Thirdly, the OFT is also inadequately resourced for its present enforcement role. While we were not able to investigate this in detail, it would seem that the level of evidence required for the Director General to revoke a licence is a brake on levels of enforcement. In the course of the interviews, however, creditors, trading standards officers and others said they felt that the OFT is too reluctant to revoke a licence, citing specific examples to support their views. Underlying this reluctance seems to be two concerns - about the likely consequences for the lender of revoking a licence, and about the possibility of a lengthy and costly legal appeal.

Finally, part of the problem with unlicensed lending is that enforcement lies with a number of bodies – trading standards for lending without a consumer credit licence, the police for harassment or acts of violence and the Benefits Agency for holding someone else’s benefit books as security. At present, unless it can be arranged that all three organisations bring their case to court on the same day, these offences are treated quite separately.

3.3 Other solutions to the problem of extortionate credit

It is clear that part of the solution to extortionate credit lies outside the legislation and its enforcement. This includes better consumer information and providing alternative courses of action for people who, at present, have (or believe they have) little choice but to borrow from lenders who exploit their vulnerability.

3.3.1 Consumer information

As Chapter 2 has shown, consumers generally are not well informed about consumer credit. This becomes especially problematic when they have little or no choice about the type of lender they can use. In such circumstances, there is a need for more consumer information about almost all aspects of the consumer credit agreement.

The OFT have a record of producing some excellent information materials for the public. What is needed, however, is a wide-ranging information campaign, involving television and newspaper advertisements as well as printed materials. While responsibility for this will, almost certainly, lie with the OFT, the Financial Services Authority also has a remit for consumer information provision and there would almost certainly be room for co-operation. Likewise there is probably scope for co-operation with the credit industry trade associations. By the nature of things, their members will be drawn from the reputable end of the market and it is not in their interest, any more than that of consumers, for the more unscrupulous end of the market to exist.

The topics on which more information needs to be provided include:

- How to compare the costs of credit, in terms of APRs and the total cost of borrowing. This should cover the ‘hidden costs’ and buying ‘colourable goods’. There also needs to be some guidance on the prevailing rates of interest for different types of credit. As these are subject to change, a broad range figure, based on historical data, could be given.

- How to compare the terms and conditions of credit, including some of the conditions that are considered to be extortionate. The current guidelines on non-status lending offer a good starting point for this information.
- Sales practices to be wary of. Including those deployed by brokers and retailers who sell credit.
- The dangers of securing loans against a private home, and especially of being talked into consolidating a first mortgage on the home with other secured loans.
- The advisability of seeking debt advice, rather than taking out a debt consolidation loan, especially one that is secured.

For the most part, this information needs to be made available at the point where a consumer is considering taking out a loan. As many people identify non-status secured lenders through newspaper advertisements, display advertisements on the same pages would be particularly effective. This would apply particularly to information on the dangers of secured loans and on seeking debt advice. Other information could well be targeted on the most vulnerable groups, using the geo-demographic approach that most lenders now take to marketing.

3.3.2 Creating alternatives to the use of extortionate credit

As discussed in Chapter 2, people use the most unscrupulous lenders for two main reasons. First, because there are people who need to borrow small sums of cash to tide them over a short period of time and cannot borrow from the more reputable alternative lenders. And, secondly, because there are those who need to borrow fairly substantial sums to deal with debts but no reputable lender in the non-status market will lend to them. The alternatives to extortionate credit for these two groups of people differ quite markedly.

Social lending
For the first group, some form of social lending is needed. Indeed, many European countries have a social lending scheme that offers credit to people who would, otherwise, use the alternative credit market. In some countries, such as the Netherlands, this is in the form of a social bank. In others, France and Italy for example, the state operates a pawnbroking service.

There is no real equivalent in the UK, although both the Social Fund and credit unions have the potential to meet this need. Both are currently under review with the aim of making their services more responsive to needs. A discussion of how this might be achieved is beyond the scope of this study, except to say that to combat extortionate credit, they need to be able to make small cash loans to people with no possibility of saving in the short term. They also need to be targeted on people who have very restricted access to alternative credit providers: lone parents, the long-term unemployed, people living on high-crime estates and hostel dwellers.

Debt advice
Social lending is unlikely to deal with the needs of people who turn to non-status secured lenders for debt consolidation loans. Indeed, it is doubtful whether further borrowing is advisable in such circumstances and seeking debt advice is almost certainly a more appropriate course of action.

It is interesting to note that the last few years have seen the establishment of fee-charging debt advice companies. All negotiate a means of repayment with creditors on behalf of the debtor and some of the larger companies actually manage the repayments as well. Some charge a percentage of the repayments, 15% being a fairly typical fee; others charge a flat-rate consultation fee, which can be several thousands of pounds. What is particularly interesting about these companies is that they attract customers by advertising in the tabloid newspapers, alongside the advertisements for debt consolidation loans. Some typical advertisements include:

> **DEBT**
> **PROBLEMS?**
> **Call…**
>
> **Debt stress?**
> **We have the INSTANT solution! WITHOUT A LOAN.**
> **We can consolidate your debts into one, reduced affordable payment.**
>
> **‘FINANCIAL PROBLEMS?**
> **DON’T BORROW, we can solve your problems without a loan.**

Research in progress on this new debt advice market indicates that many of their customers do, in fact, use them as an alternative to further borrowing. Indeed, they often identify them almost by accident while looking in the newspaper for a source of loans(Whyley and Collard, 1999, forthcoming).

The number of people using these fee-charging services is likely to be small in comparison with those turning to free advice services. But these free services are almost without exception operating to the limits of the capacity of their staffing and other resources. As such they could not contemplate advertising in the ways that the fee-charging companies do, since they would be unable to meet the resulting demand. This raises the question, should it be left to the fee-charging companies to offer an alternative to debt consolidation loans, or should the free services be given the resources to allow them to advertise? One suggestion has been that a national free-phone service should be funded from central government and industry funds. This would offer a combination of self-help packs and referral to the nearest free advice service. Provided that some additional resources were made available to the advice agencies receiving the referrals, the free-phone service could advertise in the tabloid press in the same way as the fee-charging companies.

3.4 Summary and recommendations

There a number of ways in which vulnerable consumers could be given better protection. These include improving the legislation, improving the enforcement of that legislation and offering an alternative to the use of extortionate credit.

The legislation on extortionate credit could be improved in a number of ways.

- Third parties should be allowed to initiate proceedings on behalf of borrowers.
- Judges should be able to re-open cases on their own initiative.
- Information and guidance on interest rates and credit terms and conditions should be provided to judges to help them identify extortionate credit agreements and provide the appropriate forms of redress.

Legislative changes regarding costs, include:

- Interest rate ceilings should only be considered in conjunction with measures to ensure that social lending facilities are available to people who would be unable to obtain loans at interest rates below the ceiling.

- Consideration should be given to setting presumptive interest rate ceilings, above which a lender would have to justify their charges but only with the same proviso, set out above in relation to absolute ceilings.
- The regulations concerning costs and APRs should be reviewed in order to make credit transactions more transparent.

While legislative changes relating to the terms and conditions of loans include:

- Non-status lenders offering secured debt consolidation loans should not be permitted to take possession of the property, unless they can prove that they checked the borrower's ability to repay at the time the loan was agreed.
- The regulation of discounted interest rates on secured loans should be tightened.
- The legislation regarding the linkage between brokers and lenders in cases of secured lending should be re-assessed and, where appropriate, tightened to increase lenders' responsibility for the actions of the brokers, and make brokers more accountable for the loan agreements they arrange.
- The suitability of the rule of 78 for long-term loans should be re-examined

Finally, there is a need for tougher penalties both for lending without a licence and for breaking other provisions of the Consumer Credit Act.

- All similar agreements issued by the lender should be re-opened if one of them is found to be extortionate by the courts.
- The Office of Fair Trading should be notified of all judgements involving extortionate credit, and repeat offenders should have their Consumer Credit licences revoked.

Improving enforcement is largely a matter of additional resources both for trading standards departments and for the OFT.

- The current fragmentation of enforcement against unlicensed lenders should be reviewed and addressed.
- Trading Standards Departments and other enforcement agencies should be allowed to initiate proceedings on behalf of borrowers against lenders who are issuing extortionate credit agreements.
- Additional resources should be made available to Trading Standards Departments, the Office of Fair Trading and other enforcement agencies to enable them to collect evidence against lenders who are issuing extortionate credit agreements.
- Consideration should be given to ways of reducing the level of proof, particularly the proof of 'persistency', required for the Office of Fair Trading to revoke a Consumer Credit licence.

Finally, some potential solutions lie entirely outside the processes of law.

- A consumer information campaign is necessary to raise awareness of the key factors borrowers should take into account when seeking credit. This should be wide-ranging, including adverts on television, radio and in tabloid newspapers. However, targeted campaigns should also focus on particular geographical areas where unscrupulous lenders are known to operate.
- Alternatives to extortionate credit, such as social credit and debt advice, should be made available, provided with secure funding and widely advertised. This should include a national free-phone service offering advice, self-help materials and referral.

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