

Irresponsible lending

Summary of responses to the OFT's consultation on the scope of the irresponsible lending project

December 2008

OFT1012resp

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1 INTRODUCTION

- 1.1 The Office of Fair Trading (OFT) issued a consultation paper on 1 August 2008 on the subject of the scope of a project to consider conduct which might constitute- and/or contribute to- irresponsible lending for the purposes of the 'fitness test' as set out in section 25 of the Consumer Credit Act 1974 (the Act).
- 1.2 The objective of the project is to provide a clear OFT position on the test for irresponsible lending under section 25 of the Act and to subsequently publish guidance setting out the types of behaviour the OFT considers to fall within the category of unfair business practices which will call into question fitness to retain or be given a consumer credit licence.
- 1.3 We received a total of 58 responses to our consultation from a range of stakeholders (respondents listed at Annexe A) and have produced a summary of the views expressed.

2 SUMMARY OF RESPONSES TO QUESTION ONE

Question One: Do you agree with the OFT initial view that the scope should cover all stages of a lending transaction?

- 2.1 Of the 58 responses received, 34 respondents were largely in agreement with the OFT's initial view, as set out in the consultation document, that the scope of the project should consider all of the stages of the lending process (including, for example, advertising and the handling of default and arrears) and should not be limited to consideration of practices relating specifically to the decision to lend. The following is a summary of the comments received.
- 2.2 The Association of Finance Brokers (AFB) agreed that the project should be wide in scope and that consideration should be given to 'all stages of the lending transaction, ensuring that all issues potentially involved with irresponsible lending can be considered.' This view was further endorsed in the response received from the Association of Mortgage Intermediaries (AMI).
- 2.3 CIFAS, the UK's fraud prevention service, stated that whilst it is aware that there have been concerns expressed in some quarters that the proposed scope of the project is too wide, it does not share those concerns provided that the OFT adheres to the methodology outlined in the consultation document (for example, taking account of existing legal precedents and consulting fully with stakeholders prior to publication of the final report).
- 2.4 The Financial Services Authority (FSA) stated that 'Whilst the responsible lending rules in MCOB (Mortgage: Conduct of Business Rules) are confined mainly to the lending decision, this simply reflects that authorised mortgage firms are bound by our Principles for Business which encompass the sales process. These principles require that firms dealing with borrowers should consider their interests and treat them fairly and communicate in a way that is clear, fair and not misleading.' The FSA further stated that it considered that the absence of equivalent overarching conduct of business rules under the consumer credit

licensing regime suggested a greater need for the project to consider irresponsible lending by reference to all stages of the lending process.

- 2.5 We received responses from 13 individual businesses, 5 of which expressed a preference for the project to consider the wider aspects of the lending process. Equifax considered that the project should take account of all stages of the lending process and, where applicable, the conduct of all parties involved in the granting of a loan.
- 2.6 Citizens Advice stated that it believed that 'UK consumer credit markets need a proper selling regime that is significantly different from the current over reliance on contractual information. Therefore setting the foundations for such a selling regime should be the aim, scope and main outcome of the irresponsible lending project.'
- 2.7 However, 20 respondents stated that the project should adopt the narrow scope set out in paragraph 3.3 of the scoping paper. This states that; 'the project will consider behaviour and practices around the decision to lend, or to extend an existing line of credit, and the nature and extent of any assessments of a borrower's ability to repay.'
- 2.8 Hertfordshire Savings and Loans plc stated that the wider aspects listed in the scoping document 'would create ambiguity, and the potential for duplication seems likely and unnecessary.'
- 2.9 The Association of Payment and Clearing Services (APACS) supported the narrower project scope stating that 'we consider that the key stage in a lending transaction is the actual decision to lend. We believe that irresponsible lending may occur when the practices adopted by the lender in arriving at the decision to lend are deceitful or oppressive or otherwise unfair or improper.'
- 2.10 The Consumer Finance Association, Cattles PLC, BP Law and the Civil Court Users Association all considered that there is already sufficient regulation of all elements of lending and that consequently further guidance is unnecessary.

2.11 A number of respondents pointed in particular to the fact that certain thematic areas, such as credit advertising, were already the subject of specific legislative requirements (the Consumer Credit (Advertisements) Regulations 2004) and extensive OFT guidance. They contended, therefore, that further consideration of such matters and/or the production of any further guidance would be unnecessary and that, in any case, they were irrelevant to any consideration of the concept of irresponsible lending.

OFT view

2.12 Although it is the case that the consumer credit sector is already subject to extensive legislative and other regulatory controls, we do not consider that this renders the project and/or the subsequent production of further guidance unnecessary.

2.13 There are specific legislative requirements and OFT guidance covering, for example, credit advertising. However, the existing OFT guidance on credit advertising is focussed on interpretation of the advertising regulations rather than the direct applicability of section 25 of the Act for the purposes of assessing fitness to hold a consumer credit licence ('the section 25 test') in circumstances where businesses fail to follow the guidance. Marketing practices may be **unfair** for the purposes of the section 25 test even if they are not in themselves in breach of the Consumer Credit (Advertisements) Regulations 2004.

2.14 We are also of the view that some business models might incorporate irresponsible lending practices that do not lend themselves to being simply 'segmented' into constituent elements but might rather form parts of a continuum of bad practice. For example, marketing directed at a specific category of vulnerable consumers because it is perceived that they might be particularly susceptible to inappropriately (taking account of their personal circumstances) being persuaded to take out a certain type of loan. In our view, this would be an example of where the marketing could be considered an integral part of any irresponsible lending practice. Whilst it may be the case that we might not consider it necessary to provide further detailed guidance on advertising per se, we

believe that it would be helpful to have the ability to make clear our position on any 'linked conduct' of this kind, should we identify the need to do so.

- 2.15 The aim of the project is to produce a level of clarity and certainty around **all** the issues that the OFT will consider relevant to irresponsible lending in the context of the section 25 test. The guidance should promote compliance and facilitate successful regulatory actions when appropriate. It should also aid consumer advisory groups and the large proportion of compliant businesses in the market to more readily identify when non-compliant businesses engage in practices that the OFT has specified as being inconsistent with fitness to hold a consumer credit licence.
- 2.16 On the basis of the above, we are content that there are clear benefits to be derived from this project considering all stages of the lending process.

3 SUMMARY OF RESPONSES TO QUESTION TWO

Question two: Are there any other factors which you think should be included within the project?

3.1 The issues raised in response to this question broadly fell into three main areas:

- irresponsible borrowing by consumers
- enhanced data sharing, and
- treatment of particularly vulnerable consumers.

Irresponsible borrowing

3.2 13 respondents were of the view that the project should consider the concept of irresponsible borrowing.

3.3 HSBC stated that 'whilst the fitness to hold a credit licence does not mention the activities of borrowers, the fact they should be borrowing responsibly also, in some way, needs to be factored into the OFT's views'

3.4 The credit reference agency, Callcredit, stated that 'consumers should be urged to consider their own responsibilities. Responsibility in lending has been heavily driven in recent years and responsibility in borrowing should also be promoted.'

3.5 The Finance and Leasing Association (FLA) stated that 'It is important that prospective customers are also expected to act in a responsible way when deciding whether to take out credit.'

Data sharing

- 3.6 7 business respondents (including credit reference agencies) suggested that a consideration of data sharing and data access should be included within the scope of the project.
- 3.7 Experian stated that 'credit bureaus are reliant on lenders providing information on their credit accounts in order to build lending tools. Increasingly there is data that could add value to what credit bureaus can provide, in particular around the non/sub prime market'.
- 3.8 The Consumer Credit Trade Association (CCTA) stated that 'the scope of the project should be extended to review data availability in the UK including a review of any barriers to data sharing'.
- 3.9 The Association of Mortgage Intermediaries (AMI) took a slightly different approach by stating that 'the project may also wish to consider an intermediary's ability to obtain credit reference information for potential borrowers. With many companies removing the use of data supplied by Credit Reference Agencies (CRAs) for intermediaries, clients may be at risk from multiple footprints being left on their credit file from firms unable to find out all the information they require from one source.'

Vulnerable consumers

- 3.10 9 consumer groups emphasised the importance of considering the particular needs of vulnerable consumers, specific mention being made of the elderly and those with mental health problems.
- 3.11 Mind stated that 'it would be irresponsible if lending occurred where someone clearly lacked capacity to make financial decisions for themselves such as someone in a very manic episode of bipolar.'
- 3.12 Advice Northern Ireland stated that it had observed that 'current marketing information on loans is sometimes complex and difficult to understand, even for people who have a substantial level of knowledge and confidence about financial products. At present there is a poor level of financial literacy and financial capability in Northern Ireland particularly

for the most vulnerable groups such as people on low incomes, older people and those with learning disabilities.'

Local Authority Trading Standards Services considerations

3.13 Local Authority Trading Standards Services (TSS) respondents identified a number of additional issues that they thought ought to be considered within the scope of the project:

- payment of fees and charges
- clearer notice of cooling off periods
- information provided during the term of an agreement
- more clarity of the likelihood of securing a loan at the advertised rate
- more control of personal data, and
- commission payments.

OFT view

3.14 It is part of our regulatory approach to seek to educate consumers through the provision of appropriate guidance and we will include issues relating to irresponsible borrowing in this context. In our view, the extent to which irresponsible borrowing is made possible in many (although not all) instances may, at least to some degree, be directly related to the effectiveness or otherwise of a lender's systems and procedures for assessing creditworthiness and ability to repay. This includes its procedures for considering the integrity of information supplied by potential borrowers which in part inform such assessments.

3.15 Issues around access to data and data sharing are central to lending decisions and to that extent are relevant to the project. We are aware of a number of initiatives that are currently looking at ways of improving data sharing. Whilst we recognise that improved data sharing may facilitate better informed lending decisions, we also understand that this

needs to be balanced against privacy and data management considerations. Whilst we will explore these matters further with stakeholders, the only consideration that we currently believe to be central to fitness considerations under the section 25 test is that businesses use the available data effectively and responsibly, within existing legislative constraints.

- 3.16 The project will consider issues that may impact on particular groups of vulnerable consumers, such as those with mental health issues. If appropriate, we may make specific recommendations in guidance as to conduct that we would consider relevant to the section 25 test when loans are being provided to members of any such groups.
- 3.17 We will give due consideration to the additional issues highlighted by our enforcement partners in TSS within the context of the project. However, our preliminary view is that some of the concerns they have raised might only be **fully** addressed via legislative reform (as opposed to via OFT guidance).

4 SUMMARY OF RESPONSES TO QUESTION THREE

Question three: Are there any factors which you think should not be included within the scope of the project?

4.1 The consultation document specified a non-inclusive list of factors beyond the decision to lend that impact upon lending and borrowing decisions to a significant extent or which may potentially cause consumer harm. The following indicative list was included:

- advertising and marketing
- selling techniques
- product design
- use of credit scoring techniques
- appropriateness of product to borrower
- sale of associated products, and
- account management (including handling of default/arrears).

4.2 While respondents variously commented on all of the factors listed above, 'advertising and marketing' and 'account management' featured most prominently in the responses received.

4.3 Both the Direct Marketing Association and the Advertising Standards Authority identified potential for OFT recommendations in guidance to overlap with existing regulatory tools and mechanisms. One respondent suggested that 'those companies advertising and marketing credit products are bound to assess financial status and ability to repay amongst those applying for credit'. It considered that as no decision to lend is taken at the marketing stage, it was unclear why any consideration of marketing should be included in the scope of the project.

- 4.4 Respondents who favoured the project being narrower in scope were predominantly against any consideration being given to the handling of arrears and default; their primary contention being that any issues arising from the handling of arrears and defaults are not directly connected to the lending decision assessment which is at the time of application.
- 4.5 Clydesdale Bank plc stated that 'arrears and default management should not be included in the scope of the consultation on irresponsible lending. This area is already sufficiently regulated by the Consumer Credit Act, Banking Code and the Office of Fair Trading regulation and guidance. We believe that current regulation is sufficient to safeguard the consumer in the event that they fall into arrears and ensures lenders follow a rigorous process.'
- 4.6 ASA Associates stated: 'Although it is true arrears and default can be the end results of poor lending decisions, the two should not be looked at together in this case as it does not complete the whole picture it only confuses it.'
- 4.7 The Consumer Credit Trade Association (CCTA) stated that; 'the overall opinion of the CCTA Responsible Lending Working Group is that account management (including handling of default/arrears) be excluded from the scope of the project as this activity is considered outside the parameters of irresponsible lending.'

OFT view

- 4.8 Whilst it is the case that marketing **precedes** the decision to lend, we have encountered business models and product design in which the entire set up from marketing at the front end to the handling of arrears and default at the back end appears to be premised on promoting- and subsequently benefitting from- what we might classify as irresponsible lending. In such cases, marketing and advertising play an intrinsic part in introducing borrowers to what for them may be a wholly inappropriate financial product.

4.9 The OFT has come across instances, particularly in relation to secured lending, where the approach to handling arrears and defaults appeared to be specifically designed to facilitate the lender's access to equity with no apparent regard to the borrower's ability to repay. Consequently, we consider it appropriate to include considerations of account management within the scope of the project to the extent that it is relevant and appropriate to do so.

5 SUMMARY OF RESPONSES TO QUESTION FOUR

Question four: Do you have any other comments or suggestions on the scope of the project?

- 5.1 Concerns have been expressed by a number of respondents regarding the 'fit' of the proposed guidance into an already complex regulatory landscape. The most commonly expressed concern has related to the compatibility of any guidance with the requirements of the Consumer Credit Directive (CCD) following its implementation.
- 5.2 A number of industry respondents voiced concerns about the potential impact of the guidance beyond the boundaries of the section 25 test including, for example, on cases involving consideration of unfair relationships.
- 5.3 Bank of America stated that 'increasing the scope to cover all stages of the lending transaction increases the risk that the guidance will not fit consistently within the existing regulatory framework, may be in conflict with existing laws or codes of practise, and will lead to regulatory creep and/or 'gold plating'.'
- 5.4 Bank of America stated further that 'There will be an additional burden to industry, even for the majority of lenders who are compliant with the guidance. As well as the internal compliance monitoring costs, there will be the increased cost and burden of demonstrating compliance as a result of increased FOS (Financial Ombudsman Service) complaints, trading standards enquiries and action by claims management companies. This is because the existence of published regulatory guidance will form the basis for an increased volume of complaints, enquiries and claims whether or not these have foundation. The wider the scope of such guidance, the greater the likely burden.'
- 5.5 Royal Bank of Scotland (RBS) stated that 'the OFT must take care to ensure that it is consistent with existing arrangements which are outside of the OFT's own remit, for example, the approach set out in the FSA's MCOB rules or the relevant provisions in the Banking Code. Such an

approach would aid compliance by firms and enhance consumer understanding and confidence. In relation to the MCOB rules, as the FSA will be reviewing these shortly, RBS would urge the OFT to engage with the FSA as part of this process in relation to irresponsible lending aspects.'

- 5.6 The Association of Payment and Clearing Services (APACS) has further stated that 'In the current climate, the OFT needs to be very aware of the risk of over regulation of the mainstream lending market and it is important that any outcomes from the project do not lead to an unintended consequence of consumers being driven towards high cost unscrupulous lenders.'
- 5.7 A number of respondents referred to the complexity and breadth of credit markets and identified a need to fit guidance to the specific operation of different sectors.
- 5.8 The Money Shop stated: 'We think that proportionality should be included in the scope. For example how a £20,000 loan and the requirements for that loan should differ from the requirements of a £200 loan. Any new imposed guidance which is sufficiently detailed to include additional costs to the borrower will have a significant impact on the cost of borrowing £200, in contrast to the same cost allocated to a £20,000 loan.'
- 5.9 Hertfordshire Savings & Loans plc stated that the project should 'prevent any further changes which would involve firms in additional cost which would inevitably be passed on to consumers; particularly those in the lower value loans sector who tend to be most vulnerable or disadvantaged consumers.'
- 5.10 Two respondents proposed that a cost-benefit analysis of the project should be undertaken. The Consumer Finance Association (CFA) and Cattles plc both stated that 'there is no provision in the Office of Fair Trading Irresponsible Lending Scoping paper for a cost/benefit analysis of the proposed intervention. To comply with the Regulator's Compliance

Code, this should be built in to the consultation process and no action be taken unless the benefits justify the costs.'

OFT view

- 5.11 The project is specifically intended to provide clarity and guidance as to conduct and practices that the OFT considers constitute- or contribute to- irresponsible lending for the purposes of the section 25 test. We are committed to ensuring consistency of approach with other relevant regimes to the extent that is possible given the inherent differences between the consumer credit licensing regime and other relevant regulatory regimes, including that supervised by the Financial Services Authority.
- 5.12 In producing guidance we will also have full regard for the anticipated impact of the CCD once implemented.
- 5.13 We anticipate that much of what the guidance will include will set out what responsible lenders should be doing already. Consequently, for fair-dealing businesses that already have systems in place to ensure that they assess creditworthiness and ability to repay and do not treat borrowers unfairly, the extent to which they would incur any **additional** compliance costs should be constrained. However, whilst we will have regard for any additional costs of compliance that businesses might face in ensuring that they avoid engaging in the unfair business practices outlined in the guidance, incurring some such costs may be unavoidable. Our aim will be to ensure that any such costs incurred are proportionate to the consumer harm that the guidance is seeking to prevent.
- 5.14 We are acutely aware of the risks associated with potentially driving up the cost of borrowing and the detrimental impact that this could have for some of the most vulnerable consumers. At the same time we are aware that these self-same consumers are amongst those most at risk from irresponsible lending practices and consequently most in need of enhanced protection.

- 5.15 The operation of the consumer credit licensing regime already imposes a compliance cost on licensed businesses. This is an appropriate and necessary cost given the need to regulate the risks to consumers. We will seek to balance the need to keep any additional costs to what are necessary whilst ensuring at the same time that an appropriate level of consumer protection is achieved.
- 5.16 Given the scope of the project, we do not consider that at this time sufficient data is available to us to undertake any meaningful form of cost-benefit analysis. As the project progresses and we capture more data we will be better placed to consider likely costs of compliance and anticipated levels of potential benefit to consumers which would be derived from businesses complying with the guidance. Given current levels of personal debt in the UK we anticipate that there is considerable scope for the benefits to significantly outweigh any additional cost burden.

6 SUMMARY OF RESPONSES TO QUESTION FIVE

Question five: Do you agree with or have any comments or suggestions relating to the proposed methodology?

6.1 No respondents were substantively opposed to the proposed methodology.

7 CONCLUSION AND NEXT STEPS

- 7.1 On the basis of the responses received we have concluded that the project should look at all aspects of the lending process as proposed in our consultation document.
- 7.2 The project's purpose is linked to one of the key elements of the Regulators' Compliance Code - namely taking a 'proactive approach towards ensuring compliance by helping and encouraging regulated entities to understand and meet regulatory requirements more easily'. In this case the regulatory requirement in question is the fitness test under section 25 of the Consumer Credit Act 1974 (the section 25 test).
- 7.3 The OFT's overarching purpose is to facilitate competitive markets in which innovative businesses flourish and consumers are treated fairly. We want to set down clearly the types of conduct that we consider unfair so that licensed businesses know what is expected of them and consumers are made aware of business practices that they should not expect to experience when dealing with responsible businesses. If businesses engage in unfair practices then they should expect to be subject to appropriate action by the regulator.
- 7.4 In our discussions with industry groups, as well as in some responses, the point has been made that there is danger of what has been described as a regulatory 'layering' effect caused by the issue of guidance of this kind. There is concern that some claims management companies or action groups might use any guidance out of context to unfairly prejudice consideration of issues beyond the application of the section 25 test. Several stakeholders have made particular reference to a possible knock-on effect to cases involving the unfair relationships provisions of the Act.
- 7.5 It is important to reiterate that the guidance is specifically intended to be used in the practical application of the section 25 test. We will have full regard to the possibility of such 'layering' effects and will, where it is felt necessary, issue clarification in respect of any parts of the guidance

that we consider might be susceptible to unintended uses of this, or any other kind.

- 7.6 There is already some existing regulatory overlap to the extent that the OFT and other enforcement bodies may be able to take action in respect of the same misconduct. There may also be a choice of regulatory tools with which to take any such action. Should it be the case that OFT guidance creates any further such overlap, it should continue to be the case that the most appropriate body will take whatever regulatory action is required in a proportionate manner, using the most appropriate enforcement tool available.
- 7.7 It is essential for us to maintain an open and ongoing dialogue with all stakeholders throughout the lifetime of the project. Our aim is to issue draft guidance in spring of 2009 for consultation, following which we intend to issue the final guidance in summer of the same year.

A LIST OF RESPONDENTS

Advertising Standards Authority

Advice NI

Age Concern

ASA Associates

Association of Finance Brokers

Association of Mortgage Intermediaries

Association of Payment and Clearing Services (APACS)

Bank of America

Banking Code Standards Board

Birmingham Trading Standards

BP Law

British Cheque Cashers Association (BCCA)

British Retail Consortium

Callcredit

Cattles plc

CIFAS

Citizens Advice

Citizens Advice Scotland

Civil Court Users Association

Clydesdale Bank PLC

Consumer Credit Association

Consumer Credit Counselling Service

Consumer Credit Trade Association

Consumer Finance Association

Council of Mortgage Lenders

Department for Business, Enterprise and Regulatory Reform (BERR)

Direct Marketing Association

Equifax

European Coalition for Responsible Credit

Experian

Finance and Leasing Association

Finance Industry Standards Association

Financial Services Authority

Financial Services Consumer Panel

Hertfordshire Savings & Loans plc

HSBC

Institute of Credit Management

ISBA

LACORS

Lloyds TSB

Mind

Money Advice Trust

Mr Ross

Mr W Forbes

Mrs Sharon Fitzpatrick

Ms Katriona Chettoe

Provident Financial

Royal Bank of Scotland

Scottish Legal Action Group

Shelter

Sun Lane Ltd

Teletrack

The Advertising Association

The CBI

The Money Shop

Trading Standards Institute

Transact

B COMMENTS OR COMPLAINTS ABOUT THE CONSULTATION PROCESS

- B.1 If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

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