

Summary of responses to the consultation on 'Irresponsible Lending – OFT guidance for creditors'

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CONTENTS

Chapter/Annex	Page
1 Introduction	6
2 Status, form and content of the Guidance	8
'Implementation date'	8
Responsible lending versus irresponsible lending	9
Hard law, soft law or the OFT view?	10
Guidance should only cover compliance with statutory requirements	12
'Overlap' issues	13
Consumer Credit Directive requirements and the Guidance	14
Individual claims	17
'Prescription' versus 'principles'	19
One size fits all	20
'Word and spirit of the guidance'	21
Proportionality	22
3. Scope and impact of the Guidance	23
Creditor responsibility for conduct of brokers and other third parties	23
Application to business lending	24
Irresponsible borrowing	25
Impact on credit provision	26
Impact assessment	27

4. Explanations of credit products	29
Adequate explanations	29
Sales channels	29
Evidencing that 'adequate explanations' have been provided to borrowers	30
Agreements secured on land	34
The provision of 'help-lines'	34
5. Assessment of affordability	37
Elements of an affordability assessment	37
Income and/or expenditure as evidence of affordability	37
Open-end credit	39
Meeting repayments in a 'sustainable manner'	41
Meeting repayments 'without undue difficulty'	41
A 'reasonable period of time' to meet repayments	42
'Reasonably foreseeable'	42
Student Lending	44
Self-employed	47
Affordability is relative to borrower's financial circumstances	49
Debt consolidation	49
Increasing the total cost of credit	51
6. Pre-contractual issues	55
Encouraging borrowers to seek independent advice before a credit agreement is made	55

'Suitability' of credit products	55
Disclosure of commission	57
Mental capacity	60
Incomplete applications for credit – unsigned agreements	63
7. Contractual and post-contractual issues	67
Variation in interest rates	67
Charges	69
Rolling over existing loans/debts	69
'Apparent repayment difficulties' and 'effectively monitoring repayment record'	70
Credit and store cards	70
8. Handling of default and arrears	72
Irresponsible Lending Guidance and the Debt Collection Guidance	72
Charging orders, orders for sale and inhibitions	73
Breathing space	75
Right of set-off	78
9. Regulatory compliance	80
Evidencing adherence to the Guidance – audit trails	80
Publication of creditors' lending policies and procedures	82
Annex A. List of consultation questions	84
Annex B. List of respondents	87

1 INTRODUCTION

- 1.1 On 30 July 2009, the Office of Fair Trading ('OFT') launched a consultation on draft irresponsible lending guidance ('the draft guidance'), which identified conduct that might, in the OFT's view, constitute 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 guidance is to provide a clear OFT position on the test for irresponsible lending under section 25(2B) of the Act, setting out the standards expected of holders of consumer credit licences who are engaged in consumer credit lending and associated activities and applicants for such licences.
- 1.3 In part to respect requests for confidentiality made by some respondents to our consultation ('respondents') and in part because we believe that it will be more helpful to respondents and other interested parties, the focus of this document is on summarising the key elements of the responses received rather than publishing extracts from - or the full content of - those responses that were not subject to a confidentiality request or providing extensive quantitative data with regard to the responses received.
- 1.4 The consultation document asked a total of 36 questions¹ about the content of the draft guidance. We received a total of 78 responses to our consultation from a range of interested parties.² The majority of respondents made general comments, often supplemented with proposals for amendments to the draft guidance, rather than responding to each of the specific questions set out in the consultation document.

¹ See Annex A

² See Annex B

- 1.5 All of the comments and suggestions received have been reviewed and where we consider appropriate, they have been reflected in the guidance document that was published on 31 March 2010 ('the Guidance').
- 1.6 This document summarises the main issues raised and provides the OFT's view on those issues. To that extent, it provides an insight into the OFT's thinking in producing the Guidance and should be viewed as a 'companion' to that document. We hope that respondents and other interested parties will find it helpful in that it is, in effect, a 'frequently asked questions' document.

2 STATUS, FORM AND CONTENT OF THE GUIDANCE

'Implementation date'

- 2.1 A few business respondents expressed the view that the Guidance should have no 'retrospective effect' and enquired as to the 'implementation date'.
- 2.2 Although it was not made explicit in the Act until 6 April 2008 (the 'implementation date' of section 25(2B) of the Act) that amongst the business practices that the OFT could take into account when considering the fitness of a business to hold a consumer credit licence were 'practices in the carrying on of a consumer credit business that appear to the OFT to involve irresponsible lending', the OFT was taking such matters into account when considering 'fitness' before that time. It was clearly appropriate for us to do so if licensed businesses were engaged in irresponsible lending practices that appeared to us to be 'deceitful or oppressive or otherwise unfair or improper' for the purposes of section 25 of the Act.
- 2.3 Given that the Act covers unfair or improper business practices whether unlawful or not, the core principles set out in the Guidance are something that businesses should already - and always - have had regard to in terms of the practices and procedures that they employ. The Guidance simply helps to flesh out and provide greater transparency in respect of what we consider may constitute irresponsible lending practices and, as previously stated, we have already taken action in respect of a number of matters covered in the Guidance before it was ever issued.
- 2.4 Consequently, unlike the Consumer Credit Directive ('the CCD') which provides for new legal requirements to be implemented into UK law by a specified date, the Guidance document relates to established law (section 25(2B) of the Act) which covers business practices that the OFT considers may constitute irresponsible lending practices. Therefore, the Guidance has no 'implementation date' as such.

2.5 Where we considered that specific elements of the Guidance were not yet 'effective' at the date of its publication (31 March 2010), we listed them in Annex 2 of the Guidance.³ We will not be bringing these listed matters forward.

Responsible lending versus irresponsible lending

2.6 Some respondents suggested that the draft guidance constituted 'responsible lending guidance' rather than 'irresponsible lending guidance' and that in producing such guidance the OFT had 'gone beyond its remit'.

2.7 The OFT has a statutory duty under section 25A of the Act to prepare and publish guidance in relation to how it determines, or how it proposes to determine, whether persons are fit to hold consumer credit licences. The duty also requires the OFT to publish the guidance in such a manner as the OFT thinks fit for the purpose of bringing it to the attention of those likely to be affected by it. The relevant statutory provisions do not place limitations on the scope or form of the guidance.

2.8 It is stated in the Guidance that as well as informing creditors of those behaviours that are likely to cause the OFT to consider fitness to hold a consumer credit licence, it also provides a basis against which the OFT and its enforcement partners in Local Authority Trading Standards Services can undertake assessments of whether creditors have the appropriate skills, knowledge, experience, business practices and procedures, to be licensed by the OFT to operate a consumer credit business (the 'competence assessment'). We would expect creditors to have particular regard to the general principles of fair business practice outlined in the Guidance and to give effect to their practices and

³ The matters listed in Annex 2 of the Guidance primarily relate to elements of the Guidance that reflect new legal requirements emanating from the Consumer Credit (EU Directive) Regulations 2010 which are subject to transitional arrangements and the specifics of the agreement reached in March 2010 between the then Government and credit and store card providers as to the regulation of credit and store cards, which includes an agreed lead in time prior to the agreement becoming effective on 1 January 2011.

procedures in such a way as to facilitate these general principles being followed in practice, in order to reduce the likelihood of them engaging in practices which, in our view, may constitute irresponsible lending.

Hard law, soft law or the OFT view?

2.9 Some business respondents contended that the draft guidance constituted 'soft law' and that the OFT was 'making law through guidance'. One business respondent went further and contended that borrowers, their representatives and claims management companies, would all interpret the guidance as 'hard law'.

2.10 The 'status' of our irresponsible lending guidance is more clearly defined in the Guidance than it was in the draft guidance. It is made clear in the Guidance that its content represents the **OFT's view** as to what may constitute irresponsible lending for the purposes of section 25(2B) of the Act. As stated in paragraphs 1.7 and 1.8 of the Guidance:

'In considering a person's fitness to hold a consumer credit licence, the OFT will take into account whether he has had regard to all relevant OFT guidance.

Section 25A of the Act requires the OFT to prepare and publish guidance in relation to how it determines, or proposes to determine, whether persons are fit to hold a consumer credit licence. The OFT must have regard to its guidance in carrying out its functions under the Act.'

2.11 Paragraph 1.27 of the Guidance summarises the OFT's position in respect of the contention that borrowers and/or their representatives might view its content as 'hard law' and seek to utilise the Guidance to support individual claims against creditors on that basis:

'The primary purpose of this guidance is to inform creditors of those behaviours that are likely to cause the OFT to consider fitness to hold a credit licence rather than to identify practices which, if conducted in isolation, might call into question the validity of individual agreements.'

- 2.12 Some of the matters covered in the Guidance do reflect 'hard law'. For example, paragraphs 3.1 and 3.2 accurately reflect provisions in section 55A of the Act relating to the legal requirement to provide adequate explanations to a borrower of certain features of a credit agreement before the agreement is made.
- 2.13 In addition to 'hard law', the Act requires the OFT to take into account, in deciding on fitness matters, 'business practices appearing to the OFT to be deceitful or oppressive or otherwise unfair or improper (whether unlawful or not)' for the purposes of section 25(2A)(e) of the Act. Section 25 (2B) of the Act (the 'irresponsible lending provision') is a specific and express statutory example of the matters covered by section 25(2A)(e). It is clear, therefore, that in making its fitness assessment, the OFT is required to consider lending practices that may not be illegal per se and to provide guidance on how it views such practices.
- 2.14 Paragraph 1.13 of the Guidance makes clear that any licensing action taken by the OFT in enforcing the Guidance is subject to an independent quasi-judicial process:

'Any action taken by the OFT with a view to refusing or revoking a licence is subject to an independent decision making process. The licensee or applicant has a right to make representations to an independent adjudicator that the proposed action would be disproportionate or otherwise objectionable, prior to the adjudicator making a final decision. Following the final decision by the adjudicator, there is a further right to appeal the decision (if there is an adverse determination) to the Consumer Credit Appeals Tribunal⁴ provided that there are appropriate grounds to do so.'

⁴ The Consumer Credit Appeals Tribunal is now part of the General Regulatory Chamber of the First Tier Tribunal.

Guidance should only cover compliance with statutory requirements

- 2.15 A couple of business respondents were of the view that the Guidance should only cover the need for consumer credit businesses to comply with specific statutory requirements and that the inclusion of any other matters in the Guidance constituted an attempt by the OFT to 'bring in regulation by the back door'.
- 2.16 They suggested that in respect of matters such as 'credit advertising', for example, compliance with the Consumer Credit (Advertisements) Regulations 2004 (as amended) should be all that is required.
- 2.17 While the Guidance does include a general statement that 'the OFT would expect all advertising to comply with relevant statutory requirements and to abide by the CAP and BCAP advertising codes as appropriate', it also identifies advertising/promotional practices that may not be outlawed by statute or specifically covered by existing codes of advertising practice, but have significant implications so far as considerations of irresponsible lending are concerned. One such example can be found in paragraph 5.4 of the Guidance:
- 'Employing the use of advertising, and/or other promotional material, and/or other oral or written representations which suggest, either expressly or by implication, that credit is dependent only upon the value of equity in the property on which it is to be secured.'
- 2.18 Section 25 of the Act provides that, in considering fitness to hold a consumer credit licence, the OFT shall have regard to any matters which appear to it to be relevant and in particular any evidence tending to show that an applicant, licensee, or its employees, agents or associates, past or present, have (amongst other matters) engaged in business practices appearing to the OFT to be deceitful, oppressive or otherwise unfair or improper, **whether unlawful or not**.
- 2.19 It is clear from the above that any OFT fitness guidance needs to cover conduct that we consider to be deceitful, oppressive or otherwise unfair

or improper, which may not be explicitly outlawed by statute as well as any relevant breaches of statutory requirements.

'Overlap' issues

- 2.20 A number of business respondents made various comments relating to the extent that the draft guidance 'overlapped' with matters covered by either:
- other OFT Guidance such as, for example, the Debt Collection Guidance
 - other legislative provisions such as, for example, the Consumer Protection from Unfair Trading Regulations 2008 ('CPRs') and
 - other regulators – primarily the Financial Services Authority ('FSA').
- 2.21 With regards to overlap with other OFT Guidance, it was inevitable that this would be the case given that, following an earlier consultation on the 'scope' of the Guidance, it was decided that it should cover each stage of the lending process from advertising at the pre-contract stage to handling of arrears and default after a credit agreement has been made between a creditor and a borrower. Pre-existing OFT Guidance is being updated with a view to ensuring that it is consistent/aligned with the Guidance as appropriate. We also consider that it should be helpful to creditors and consumer advisors to have guidance relating to each stage of the lending cycle contained in a single document.
- 2.22 With regards to overlap with other consumer protection legislation such as the CPRs, it is clearly stated in both the draft guidance and the Guidance that the primary purpose for producing irresponsible lending guidance is to provide greater clarity for business and consumer representatives as to the business practices that the OFT considers may constitute irresponsible lending practices for the purposes of the 'licensing fitness test' under section 25 of the Act.
- 2.23 Under certain circumstances more than one means of regulatory intervention may be available to us. The use of our licensing powers may

be only one of our possible options and we would seek to select the most appropriate regulatory response in the light of the facts and circumstances in each case. Our position on this is covered in the sub-section of Chapter one of the Guidance entitled 'Enforcement principles' (see paragraphs 1.9 to 1.13 inclusive).

- 2.24 We discussed both the draft guidance and the Guidance with the FSA prior to publication. While both the OFT and the FSA have specific statutory obligations with regard to the regulation of their respective regimes, it is appropriate that our general approaches to tackling irresponsible lending should be consistent to the extent that this is appropriate given the differences between the Financial Services and Markets Act 2000 ('FSMA') and Consumer Credit Act 1974 regimes and the different nature of the products subject to the different regulatory regimes. We consider that there is a strong read-across between the 'General Principles of Fair Business Practice' as outlined in Chapter two of the Guidance and the FSA's 'Treating Customers Fairly' principles. Similarly, we consider there to be considerable consistency between the FSA's general approach to tackling irresponsible lending as outlined in its consultation paper CP10/16 entitled 'Mortgage Market Review: Responsible Lending', which was published in July 2010, and our approach as set out in our Guidance.

Consumer Credit Directive requirements and the Guidance

- 2.25 Some industry respondents contended that there was some inconsistency between the position adopted by the OFT in its draft guidance relative to the contents - and requirements - of the CCD and/or that the draft guidance went further than was permitted by the CCD.
- 2.26 The Guidance is primarily guidance for consumer credit licence holders as to the business practices that the OFT considers may constitute irresponsible lending practices for the purposes of the 'fitness test' under section 25 of the Act - it is not specifically intended to be guidance on the CCD. However, the Guidance (as is the case with all OFT 'fitness guidance') clearly needs to take account of key relevant legislative requirements since the absolute minimum standard that the OFT would

expect of any licensed business is compliance with relevant legal requirements. The new requirement to provide adequate explanations to borrowers in advance of a consumer credit agreement being made, being implemented into UK law by the Consumer Credit (EU Directive) Regulations 2010 ('the Regulations'), is one example of such a legislative requirement that is clearly at the core of irresponsible lending considerations.

- 2.27 At the time the draft guidance went out to consultation, the content of the Regulations was also subject to consultation and was still 'work in progress'. However, by the time that we published our Guidance on 31 March 2010 (immediately prior to the Regulations being finalised and published), taking account of both the final content of the Regulations and comments received during our consultation, we took steps to ensure that the relevant elements of our Guidance were closely aligned to the final statutory wording of the Regulations. We also provided additional supplementary information and clarification as to our interpretation of what this may mean for creditors in a practical sense (as it was appropriate for us to do in light of our statutory duty to provide such guidance under section 25A of the Act).
- 2.28 Some creditors contended that OFT expectations of what creditors might do, subject to proportionality considerations, in terms of assessing 'affordability' (with regard to a borrower's ability to meet repayments arising from a specific credit commitment in a sustainable manner), go beyond what (they consider) has previously been expected of them and beyond the new legal requirement introduced by the Regulations to assess 'creditworthiness' before a regulated consumer credit agreement is made with a borrower.
- 2.29 The OFT's 'Non-Status Guidelines for Lenders and Brokers', published as long ago as 1997, state:

'Where there is doubt over whether the borrower will be able to afford the repayments, the loan should not be made. If a lender fails to check the borrower's ability to repay a loan secured on the borrower's property, this will be irresponsible lending.'

'Although the guidelines apply only to secured lending to non-status borrowers, I [the then Director General of Fair Trading] would hope that **all** lenders and brokers will consider the extent to which the principles of good business practice contained in the guidelines may be applied to all aspects of their business activity.'

2.30 Any OFT guidance on irresponsible lending that did not include an expectation that creditors should undertake some form of assessment, before the credit agreement was made, of whether the borrower could afford to repay the credit, would appear to us to contain a very significant omission. Indeed, virtually all of the respondents to our earlier consultation on the proposed scope of our Guidance, both business and consumer representatives, appeared to us to be of the view that this should be the most important element of the Guidance.

2.31 In December 2009, in its own published summary of responses to its consultation on the implementation of the CCD, the Department for Business, Innovation and Skills ('BIS') stated:

'The majority of industry respondents disagreed with BIS' proposed approach for implementing Article 8.⁵

Several industry respondents contended that the UK's Lending Code, CCA⁶ and the impending OFT guidance on irresponsible lending were sufficient to meet the requirements of Article 8.

We recognise that the specific prohibition on irresponsible lending introduced in the CCA, now the subject of detailed OFT guidance currently in the process of formulation, already deals with these matters. Indeed, safeguarding this provision of the CCA was a key UK objective during negotiation of the CCD. Responsible lending and affordability are complex concepts and cannot be adequately

⁵ Article 8 of the CCD relates to the requirement for creditors to assess creditworthiness.

⁶ 'CCA' is the BIS abbreviation for the Consumer Credit Act 1974.

dealt with without lengthy and detailed explanation. This cannot be provided on the face of legislation. Furthermore, unlike guidance, legislation is inflexible and is not easily amended or updated. Guidance can be kept up to date in light of developing practice and can more readily take account of the ongoing representations of key stakeholders in the light of practical experience.

Against this background it therefore makes sense to limit implementation of this aspect of the CCD to what is strictly necessary – a legal provision requiring lenders to check creditworthiness – and to deal with the more complex issues of irresponsible lending and affordability in OFT guidance. The draft implementing legislation will not, therefore, attempt to describe in detail how consumers' creditworthiness is to be checked or even to define creditworthiness, but, at the same time, neither will it limit the OFT's room for manoeuvre in producing guidance on affordability as an aspect of responsible lending in accordance with the requirements of the CCA.'

Individual claims

- 2.32 A number of business respondents expressed concern that the Guidance would prompt unjustified claims by borrowers, both via claims management companies and directly, to businesses, the courts and to the Financial Ombudsman Service, that they had suffered some form of loss as a consequence of irresponsible lending practices engaged in by a creditor. Indeed, some respondents suggested that the Guidance would act as a 'checklist' for those wishing to make such claims.
- 2.33 Paragraph 1.27 of the Guidance makes clear that its primary purpose is to inform creditors of those behaviours that are likely to cause the OFT to consider fitness to hold a consumer credit licence rather than to identify practices which, if conducted in isolation, might call into question the validity of individual agreements.
- 2.34 However, it is inevitable that the provision of any new OFT 'fitness guidance', which provides greater clarity to businesses in terms of what we consider may constitute unfair or improper conduct, will provide

some insight to borrowers and their representatives as to circumstances in which they **may** have a legitimate basis for seeking some form of redress where they consider that they may have been treated unfairly by a creditor.

- 2.35 This will similarly be the case where new legal requirements, such as, for example, those being introduced by the Regulations which require creditors to provide adequate explanations of credit agreements and to undertake assessments of creditworthiness before a consumer credit agreement is made, first come into effect. In the same way that the Government, as a matter of law, is required to implement the requirements of the CCD into UK law, the OFT is similarly under a statutory duty to prepare and publish guidance in relation to how it determines, or proposes to determine, whether persons are fit to hold a consumer credit licence.
- 2.36 Borrowers have legitimate rights to seek redress from businesses where they feel that they have suffered loss as a result of the unfair or improper conduct of consumer credit businesses. If they wish to employ the services of claims management companies, duly licensed by both the Ministry of Justice and the OFT, to assist them in this process, then they have a right to do so. Consequently, businesses should anticipate that they may receive such complaints and allow for this in their business plans.
- 2.37 We would anticipate businesses, the courts and the Financial Ombudsman Service may have some regard to our Guidance when considering complaints of this kind. To the extent that this is the case, we would hope that this might help facilitate those borrowers who are legitimately entitled to some form of redress receiving what is due to them and vexatious complaints being dismissed at the minimum cost and inconvenience to the business concerned.

'Prescription' versus 'principles'

- 2.38 Views about 'the form' of the draft guidance were polarised, with some business respondents considering that it was 'too prescriptive and should be more principles based' while other respondents sought more specific detail to 'aid certainty'. The majority of consumer respondents appeared more content with the 'balance' between specific detail and principles and tended to focus more on the basic principles that underpin much of the Guidance such as, for example, the need for creditors to operate effective policies and procedures for the assessment of affordability.
- 2.39 Given that the 'scope' of the Guidance is wide, covering all types of regulated consumer credit lending, it appeared to us to be appropriate to specify general principles that we consider apply to all lending (see in particular Chapter two of the Guidance), supplemented by more detail (rather than 'prescription') where this appears appropriate/necessary in respect of a particular type of credit agreement (for example, the elements of Chapter six of the Guidance which are specific to the agreement between credit and store card providers and the Government on the regulation of those products).
- 2.40 The Guidance certainly provides more **detail** than the draft guidance in terms of defining elements of the draft guidance in respect of which a number of respondents to the consultation sought greater clarity. An example of this is in Chapter four of the Guidance in which, in setting out our views on 'affordability assessment', we better describe what creditors need to take into account in considering such matters as the 'sustainability' of credit (from a borrower's perspective), what may constitute a borrower experiencing 'undue difficulty' and what may constitute a 'reasonable period' in which a borrower ought to be able to repay credit.

One size fits all

- 2.41 Some industry respondents considered that the Guidance could be enhanced if it was more product - and/or business model - specific, rather than generally adopting a 'one size fits all' approach.
- 2.42 This view was counter-balanced to some degree by other respondents who considered that the Guidance might be purely 'principles based' with no specificity with regard to different credit products or modes of selling.
- 2.43 The production of product - and/or business model - specific guidance would have been hugely time consuming and resource intensive. In our view, it was important that we clarified our view as to those matters we consider may constitute irresponsible lending in as timely a manner as reasonably possible in order to provide greater transparency, as soon as possible, to, in particular, licensed consumer credit businesses.
- 2.44 Product - and/or business model - specific guidance would also not be 'future-proofed' and may have a short shelf-life as new credit products and modes of credit provision are constantly being developed, with new products replacing existing products in the market and new types of businesses entering the market.
- 2.45 Therefore, the position that we consider most appropriate to adopt, is to produce a document that sets out general principles such as those in Chapter two relating to what we consider to be general principles of fair business practice, supplemented with more product - and/or business model - specific information where we consider this to be appropriate. For example, Chapter six encapsulates the essence of the agreement reached between Government and credit and store card providers with regard to the specific regulation of these credit products. Similarly, while Chapter three provides clarification on our general views as to the matters that all consumer credit businesses should take into account when providing explanations of credit products, it also provides our views on certain matters that are specific to certain sales channels (for

example, on-line sales) and certain products (see in particular pages 29 to 32 inclusive of the Guidance).

- 2.46 We will consider whether there may be benefit in producing any supplementary product- and/or business model- specific Guidance in the future, once we have had an appropriate opportunity to evaluate the effectiveness of the Guidance.

'Word and spirit of the guidance'

- 2.47 Chapter one of the draft guidance contains a statement in paragraph 1.8 that the OFT expects businesses to 'fully comply with the word and spirit' of the guidance.

- 2.48 Some respondents to the consultation considered that this statement might extend the scope of the Guidance such as to allow for 'unreasonable challenges' to be made by borrowers against consumer credit businesses with regards to their conduct.

- 2.49 The OFT has employed the use of the same or similar statements in other fitness guidance that it has produced – so its usage in the Guidance does not represent the setting of any form of precedent.

- 2.50 Paragraph 1.21 of the Guidance provides clarity as to why the OFT employs the use of this wording in its fitness guidance:

'Although the guidance identifies business practices at each stage of the lending process which, in the OFT's view, may constitute 'irresponsible lending practices', it is not an exhaustive list of all possible behaviours which might constitute irresponsible lending. Given that this is the case and that the guidance can not anticipate all possible variants of behaviour and credit products, the OFT would expect creditors, to the extent that it is applicable to them, to have regard to both the letter and spirit of this guidance.'

- 2.51 In the Guidance, we changed the wording from 'word and spirit of the guidance' to 'letter and spirit of this guidance' in order to mirror the wording contained within the Lending Code to which many consumer

credit businesses, including a number of respondents, are voluntary signatories.

- 2.52 Organisations like the Financial Ombudsman Service, when applying the test of what constitutes 'fair and reasonable behaviour' to consumer complaints, are used to taking account of matters that may fall within a wide scope of what might be considered fair or otherwise – for example, the FSA's 'Treating Customers Fairly' principles.

Proportionality

- 2.53 Some respondents to the consultation considered that there was insufficient emphasis in the draft guidance on the concept of 'proportionality'.
- 2.54 As a consequence, we have made significant revisions to the Guidance, making a number of explicit references to the fact that we would expect creditors to adopt a proportionate approach in giving effect to their lending practices and procedures – including, for example, those relating to the assessment of affordability (see paragraph 4.10 of the Guidance).

3 SCOPE AND IMPACT OF THE GUIDANCE

Creditor responsibility for conduct of brokers and other third parties

- 3.1 There were mixed responses to the view stated by the OFT that it would expect creditors to take appropriate responsibility for any acts or omissions of brokers. Some consumer organisation respondents strongly supported this view, while a number of creditors considered that it may be unreasonable.
- 3.2 On the basis of the comments received in the consultation, we considered it appropriate to provide greater clarity as to what we would reasonably expect of creditors in terms of their level of responsibility for the actions of third parties. This can be found in Annex 3 of the Guidance and it states as follows:

'The OFT considers that creditors should take **appropriate** responsibility for acts or omissions of brokers, debt recovery businesses ('DRBs') and other intermediaries or agents involved in the lending process. A broker may be a business associate and/or agent of a creditor if the broker is tied to the creditor, or has an ongoing relationship with the creditor, or frequently does business with the creditor. This will be a matter of fact and degree. Similarly, the OFT considers third party debt collection businesses that recover debts on behalf of creditors may be business associates and/or agents of the creditors on whose behalf they act. DRBs to whom creditors have assigned debts may themselves become the 'creditor' under the agreement.

It is not for the OFT to specify in this guidance how creditors' choices about third party selection are made nor to advise on desired conduct between creditors and third parties. However, the OFT would expect creditors to take reasonable steps to satisfy themselves that such persons are not engaging in unfair business practices or acting unlawfully and to take care in selecting third parties with whom to form business associations (complaints about any such third parties to be considered by creditors and action to

be taken by creditors in respect of any such complaints as appropriate). If a creditor chooses to do business and/or continues to do business with a third party which it suspects, or reasonably ought to suspect, is engaged in behaviour which the OFT is likely to consider to be inconsistent with fitness to hold a licence, its own fitness may be called into consideration. We would consider licensed businesses simply ignoring the unfair practices of those acting on their behalf - whether in-house or external – to be inconsistent with fitness to hold a consumer credit licence.'

Application to business lending

3.3 A small number of business respondents expressed concern that 'the OFT did not take the opportunity to exclude 'business lending' from the Guidance.'

3.4 As stated at the very beginning of the foreword to the Guidance, our primary purpose in producing this guidance is to provide greater clarity for businesses and consumer representatives as to the business practices that we consider may constitute irresponsible lending practices for the purposes of section 25(2B) of the Act.

3.5 As stated in section 25(2B) of the Act:

'...the business practices which the OFT may consider to be deceitful or oppressive or otherwise unfair or improper include practices in the carrying on of a **consumer credit business** that appear to the OFT to involve irresponsible lending.'

3.6 As stated in section 189 of the Act:

'consumer credit business means any business being carried on by a person so far as it comprises or relates to the provision of credit by him, or otherwise his being a creditor, under **regulated consumer credit agreements**.'

3.7 As stated in section 8 of the Act, a 'regulated consumer credit agreement' is:

'...an agreement⁷ between an **individual** ('the debtor') and any other person ('the creditor') by which the creditor provides the debtor with credit of any amount.'

3.8 As stated in section 189 of the Act, an 'individual' includes:

(a) a partnership consisting of two or three persons not all of whom are bodies corporate; and

(b) an unincorporated body of persons which does not consist entirely of bodies corporate and is not a partnership.'

Irresponsible borrowing

3.9 A number of business respondents contended that the Guidance should cover 'irresponsible borrowing' as well as irresponsible lending.

3.10 As previously stated, the objective in producing the Guidance is to provide a clear OFT position on the test for irresponsible lending under section 25(2B) of the Act, setting out the standards expected of holders of consumer credit licences, who are engaged in consumer credit lending and associated activities, and applicants for such licences.

3.11 The OFT does not licence borrowers and cannot set standards for the conduct of borrowers.

3.12 However, the Guidance does make clear that considerations of whether or not a creditor may have engaged in irresponsible lending may, in part,

⁷ Unless it is an 'exempt agreement' - see sections 16, 16A and 16B of the Act. Section 16B exempts credit agreements exceeding £25,000 if the agreement is entered into by the debtor wholly or predominantly for the purposes of a business carried on, or intended to be carried on, by him.

need to consider the conduct of the borrower. In paragraph 1.30 of the Guidance it states that:

'Borrowers also have a part to play in helping to better create an environment of sustainable credit provision. For example, where creditors' assessments of affordability rely, in part, on information provided by borrowers, it is important that such information is accurate and up to date and the borrower should advise the creditor in a timely manner of any relevant change of circumstances that is likely to significantly impact on any such assessment. Creditors would not be considered culpable by the OFT for placing reliance on information provided by borrowers, at least in part to inform such assessments, which was subsequently found to have been substantively inaccurate or untrue at the time that it was provided, where the creditor had no reason to suspect that this was the case.'

Impact on credit provision

- 3.13 Some business respondents considered that there was a risk that if they followed the Guidance this could contribute to an increase in the cost of credit provision and/or have an adverse impact on the availability of credit to some marginal borrowers. It was further contended that if this was the case this could lead to a possible increase in borrowers turning to illegal money lenders as an alternative source of credit.
- 3.14 It is of course the case that there is already significantly reduced access to credit for many borrowers. This is not as a consequence of the OFT clarifying its views as to what it considers may constitute irresponsible lending, but rather as a consequence of a reduction in both creditors' appetite for risk and available capital as a consequence of the recent economic downturn.
- 3.15 There are invariably some necessary costs associated with providing enhanced consumer protection. For example, there undoubtedly will be costs for businesses associated with complying with the new legal requirement for creditors to provide adequate explanations to borrowers

before a credit agreement is made (in accordance with the requirements of the Regulations). Nevertheless, elected representatives across the EU have taken the view that such requirements are justified in order to meet the objective of enhanced consumer protection.

- 3.16 We would expect efficient businesses to be able to comply with any such new legal requirements in a way that it is proportionate, while still providing the necessary level of consumer protection, such as to be able to obviate the need to incur excessive - or undue - additional costs. Indeed, we would expect such businesses already to be largely adhering to the general principles of fair business practice set out in the Guidance, such that little further action would need to be taken (with associated cost) to amend current practice in line with the Guidance.
- 3.17 Illegal Money Lending teams throughout the UK continue to take effective and appropriate action against loan sharks who pose a threat to consumer well-being.
- 3.18 While it is the case that vulnerable consumers can be exposed to considerable risk if they seek to obtain credit from illegal money lenders, they may also be exposed to risk if they are the subject of irresponsible lending practices in the regulated sector.
- 3.19 The OFT's aim is to facilitate the operation of a well-functioning market for both borrowers and creditors in which sustainable credit is made available to borrowers who want to borrow and who can afford to do so, on fair and reasonable terms, by fair dealing businesses.

Impact assessment

- 3.20 A few business respondents to the consultation considered that some form of impact assessment of the Guidance might be undertaken.
- 3.21 The OFT does not conduct impact assessments when producing explanatory guidance. However, we do work with interested parties in preparing such guidance and consult on the content.

- 3.22 Nevertheless, we will be evaluating the impact of the Guidance,⁸ in its own right and in concert with other regulatory changes, such as the relevant reforms being introduced by the Regulations and associated statutory instruments. The overall impact of the CCD on the UK economy and businesses has already been the subject of a regulatory impact assessment which was published by BIS in March 2009.
- 3.23 Some of the impact of the Guidance will arise through the OFT's performance of its duties. We will be considering costs and benefits arising from the carrying out of our duties, with a view to meeting our consumer protection objectives, whilst keeping the burden on the supervised community to the minimum considered necessary.
- 3.24 Given the transitional period before certain regulatory changes and associated aspects of the Guidance become 'effective', we would not anticipate undertaking this evaluation of the Guidance before the latter part of 2011.
- 3.25 In the interim, we will update/amend the Guidance as and when we consider it appropriate to do so. This will most probably be to take account of any relevant legislative developments and/or Government initiatives, but we may also do so when, on the basis of our own practical experience of applying the Guidance, it appears appropriate to do so.
- 3.26 We will endeavour to make interested parties aware as and when any such revisions to the Guidance are made.

⁸ Subject to any subsequent amendments or updates that may have been made to the Guidance at the time the evaluation is undertaken.

4 EXPLANATIONS OF CREDIT PRODUCTS

Adequate explanations

- 4.1 A number of respondents appeared to be unaware that the requirement for creditors (or intermediaries) to provide adequate explanations to borrowers of certain features of credit agreements before the agreement is made, is a new **legal requirement** being introduced by the CCD and being implemented into UK law by the Regulations. They appeared to believe that this was a new concept of the OFT's own creation that it was seeking to impose on creditors.
- 4.2 Given that this is the case, Chapter three of the Guidance covering 'Explanations of Credit Agreements' has been redrafted in a way that is much more closely aligned to the statutory wording employed by BIS in the Regulations than was the case in the draft guidance. It has been supplemented by some explanation as to how we would expect creditors (and intermediaries) to meet these legal requirements in practice.

Sales channels

- 4.3 Various business respondents expressed the view that the Guidance imposed greater burdens on creditors who used certain sales channels. However, very conflicting views were expressed by different creditors as to which credit providers might be disadvantaged relative to others on the basis of the primary sales channel employed.
- 4.4 The Guidance takes account of the different challenges faced by creditors who employ different sales channels. For example, with regard to the provision of 'adequate explanations', the Guidance acknowledges that employing the use of remote channels such as the Internet may limit a creditor's ability to take a view on the borrower's level of understanding of explanations provided.
- 4.5 The greatest concerns expressed by respondents were in respect of the provision of adequate explanations (and, to a slightly lesser extent, meeting obligations pertaining to 'mental capacity' considerations).

Respondents expressed the view that the sales channel used would be particularly pertinent in respect of such matters.

- 4.6 While we accept that this may be the case, in our view, the different challenges faced by providers who employ the use of different channels arise primarily from the underlying **legal requirements** (such as those emanating from the CCD) with regard to the provision of adequate explanations rather than as a specific consequence of explanatory guidance setting out the OFT's view. Even the more 'interpretive' elements of the Guidance arise from our consideration of steps that creditors may need to consider in order to ensure compliance with the relevant aspects (see in particular section 55A of the Act) of the implementing Regulations.

Evidencing that 'adequate explanations' have been provided to borrowers

- 4.7 Perhaps the most commonly expressed business concern, during the consultation and otherwise, is how creditors can **evidence** that they provided a borrower with an adequate explanation before the relevant credit agreement was made.
- 4.8 It is unlikely that a creditor could ever evidence definitively that a borrower had been provided with an **adequate** explanation given the subjective nature of what is or is not 'adequate'. An explanation that might subsequently have been found to have been adequate for ninety-nine out of one hundred borrowers, might, in due course, appear to have not been adequate for one in a hundred.
- 4.9 Some insight into our view of what might constitute an irresponsible lending practice with regards to this issue, and steps that creditors might or might not take, are set out in paragraph 3.30 of the Guidance and in the associated text box:.

'Pressurising or requiring a borrower to acknowledge, in writing or by any other means, that he has been provided with an **adequate** explanation.

This would include requiring the borrower to 'tick a box' or take some other form of action which has the same effect in terms of providing an 'acknowledgement'. However, this would not preclude the creditor from simply asking the borrower if he has understood the explanation provided.

In the OFT's view, it is acceptable for borrowers to be required to acknowledge in writing that they have been provided with an **an explanation** of the credit product by the creditor or his representative (provided that this was the case) – and/or that they have been provided with a copy of written information which constituted all or part of any such explanation.

'However, the borrower should not be required to provide a formal acknowledgement that any such explanation was **adequate** since the borrower may not be in a position to know with any certainty at that stage whether the explanation provided was adequate or not.'

- 4.10 In our view (for reasons stated above), the borrower should not be asked- and cannot be required- to sign some form of 'declaration' that he has been provided with an **adequate** explanation. Similarly, although the provider of an explanation may ask the borrower whether he has understood the explanation provided in order that, upon receipt of a negative response, further explanation might be provided, he should not ask- and cannot require- the borrower to sign a declaration that he has **understood**⁹ the explanation provided.
- 4.11 In spite of the above, we would contend that there are steps that creditors and intermediaries might wish to **consider** taking to increase the likelihood of demonstrating that, on the balance of probabilities, they

⁹ See section headed 'Group 18(e): Consumer Declarations' on pages 77 – 78 of OFT 311 - the OFT's **Unfair Contract Terms Guidance**:
www.offt.gov.uk/shared_offt/reports/unfair_contract_terms/oft311.pdf

have provided a borrower with an adequate explanation of the key features of a credit agreement before the agreement is made:

- **Making and keeping a detailed record of the explanation provided to a particular borrower.** A number of business respondents stated that they were opposed to this as an option because of the perceived cost/burden that it would impose on them, their representatives, staff and/or agents. While we would not dispute that there may be some cost implications/burdens associated with this approach, it **may** constitute the best means of demonstrating that, on the balance of probabilities, an adequate explanation has been provided to a particular borrower. Clearly, any creditor or intermediary opting for such an approach would need to ensure that whatever method it used to record the details of the explanation provided took account of legal requirements under the Data Protection Act 1998, the borrower's rights of confidentiality etc.
- Given that, on the basis of representations made to us we would anticipate relatively few creditors favouring keeping detailed records of explanations provided, they may, alternatively, wish to consider **asking borrowers to acknowledge in writing that they have been provided with an explanation of the credit agreement** (provided that this was the case). They could also provide the borrower with a copy of a written document setting out the general features of the explanation provided (including oral elements of the explanation where applicable) and ask the borrower to acknowledge in writing that this written document **appears to him** (the borrower) to be representative of the explanation provided (provided that this is the case). While this would not in itself demonstrate that the borrower had been provided with an **adequate** explanation, it would demonstrate that he had been provided with an explanation. By asking for the borrower's confirmation that an attached document appeared to him to be representative of the explanation that had been provided to him, an objective third party assessor (such as an officer of the OFT) would be better placed to take a view on whether such an explanation was likely to have been adequate or not given the nature of the credit agreement etc.

- If creditors employ a practice of asking borrowers to acknowledge in writing that they have been provided with an explanation of the credit agreement, they could also consider seeking to take further steps to better evidence that the borrower has not only been provided with 'an explanation' but has also **understood** the explanation provided (which would be stronger evidence of its likely 'adequacy' for a particular borrower). One method by which this could be done is by **'testing' the borrower's understanding of the explanation provided by asking him a question(s) relating to it**. If, for example, the borrower ticked the correct answer from five possible options, this would tend to suggest that the borrower had understood the explanation provided (or at least the aspect(s) tested). Interactive tools of this type are commonly employed for distance learning and may, in particular, lend themselves to testing the borrower's level of understanding of an explanation provided 'online' when the borrower is seeking to acquire credit via such a channel. However, the same basic principle could also be applied to other sales channels. We do not consider that the cost of creditors or intermediaries employing the use of such tools should be prohibitive or that the process need be unduly burdensome or time consuming for borrowers – but creditors or intermediaries may wish to take account of 'proportionality considerations' before considering the use of such tools.

4.12 We are not seeking to **prescribe** steps creditors or intermediaries **must** take in order to satisfactorily evidence to the OFT (or others) that they have provided a particular borrower with an adequate explanation. Creditors may elect to adopt alternative approaches. It is also the case that other third party assessors **may** look for different types of evidence that an adequate explanation has been provided to a borrower. We are simply seeking to provide creditors and intermediaries with some insight into some of the types of approaches they might wish to consider in order to increase the likelihood of them being able to evidence, on the balance of probabilities, that they have provided a borrower with an adequate explanation.

4.13 The OFT would have serious concerns about any creditor or intermediary which sought to inappropriately manipulate or abuse any of the possible

options set out above, or any other options, in an attempt to make it artificially appear that there was evidence that an adequate explanation had been provided when this may not in fact have been the case.

Agreements secured on land

- 4.14 Some business respondents were concerned that the OFT's draft guidance might be seeking to extend the specific CCD requirements with regard to the provision of adequate explanations before a consumer credit agreement is made, to agreements secured on land – even though it was the intention of BIS, in implementing these requirements into UK law, that they should not be applicable to such agreements.
- 4.15 The Guidance makes clear that the **specific legal requirements** of section 55A of the Act do not apply to certain categories of regulated credit agreement including agreements secured on land (see text box at the very beginning of Chapter three of the Guidance).
- 4.16 However, section 25(2) of the Act states that in considering fitness to hold a consumer credit licence, 'the OFT shall have regard to any matters appearing to it to be relevant'. We would expect creditors engaged in second charge lending, as a matter of general principle of fair business practice, to, for example, highlight (via appropriate explanation and/or information provision) key risks to borrowers before a credit agreement is made – for example, the potential consequences of missing repayments, including the risk of repossession of property on which a loan is secured.

The provision of 'help-lines'

- 4.17 In recognition of the potential difficulties that some creditors (those providing retail credit being one example) may have in providing explanations of credit products in a suitable environment, the consultation asked a couple of specific questions regarding the possibility of explanations of credit products being provided via telephone help-lines.

'Where applicable, should creditors be required to provide access to telephone 'help-lines' at point of sale?'

'Where applicable, should borrowers be able to access telephone 'help-lines' free of charge?'

- 4.18 A number of business respondents were opposed to the provision of help-lines for this purpose on grounds of both 'cost' and 'practicality'. Some consumer representative respondents were more supportive of the notion of help-lines being provided subject to certain caveats, the most common being that calls to the helpline should either be free to borrowers or, at the most, charged at local rate.
- 4.19 Some business respondents took the view that the fact that this issue was being raised at all as part of the consultation constituted recognition that complying with the new requirements in respect of the provision of adequate explanations had very different implications for providers of credit products dependent on their primary sales channels. As previously stated, while we would not necessarily disagree with this assertion, this is an inevitable consequence of the new legal requirements emanating from the CCD rather than a direct consequence of the OFT's explanatory Guidance. Indeed, the Guidance seeks to assist creditors by providing explanation and further clarity as to what we would expect in terms of the provision of adequate explanations from, in particular, creditors seeking to comply with the legal requirements who primarily or solely provide credit 'online' and at a distance. It is also the case that the Regulations, in amending the Act by the insertion of new section 55A pertaining to the provision of adequate explanations, also take account of the different challenges faced by different credit providers dependent on the primary sales channel they employ.
- 4.20 The view was expressed by one respondent that simply directing a borrower to a help-line (in store or otherwise) from which he might be provided with an adequate explanation of a credit agreement before the credit agreement was made **may not** in any case, in itself, meet the legal requirement under section 55A of the Act since this would constitute

merely 'signposting' a means of obtaining an explanation rather than actually **providing** an explanation. We would agree with this view.

- 4.21 Having weighed up the various contentions expressed on this issue, we have formed the view that the provision of help-lines is a service which some businesses **may** wish to offer their customers. However, we consider that this would, in most cases, be likely to be a **supplementary** service that borrowers might be offered rather than something that would replace the need for adequate explanations to be provided at point of sale (in a retail outlet, for example) or on-line, prior to the credit agreement being made.

5 ASSESSMENT OF AFFORDABILITY

Elements of an affordability assessment

- 5.1 A number of industry respondents presumed that a number of factors cited in the draft guidance which, in the OFT's view, **might** be taken into account in making an affordability assessment were in fact **mandatory**. The Guidance better clarifies the OFT position in this regard (see, for example, paragraphs 4.10 – 4.12 inclusive).

Income and/or expenditure as evidence of affordability

- 5.2 A small number of respondents interpreted the draft guidance as suggesting that, in the OFT's view, all assessments of affordability **had to** include a consideration of the borrower's income.
- 5.3 During the consultation process a number of creditors advised that they did not take the borrower's income or expenditure into account in assessing creditworthiness/affordability and that they employed the use of what they considered to be more accurate predictors.
- 5.4 Our position on this matter is stated in paragraph 4.15 of the Guidance and remains virtually unchanged from our position as stated in paragraph 4.12 of the draft guidance:

'In our view, creditors who do not require **documentary evidence** of income and/or expenditure as part of their assessment of affordability, but rather accept information provided by the borrower without any supporting evidence or, in the alternative, do not seek **any** information on income and/or expenditure at all as part of their assessment, should ensure that whatever means and sources of information they employ are sufficient to make an appropriate assessment. We do not consider self-certification of income would generally be sufficient in respect of significant long-term credit agreements, particularly those secured on property.'

- 5.5 This is in line with our general approach to 'assessments of affordability' and, indeed, to many aspects of preventing irresponsible lending. We understand that there are many different types of creditors providing a number of different credit products to different types of borrowers with different needs and that they are doing so via a variety of channels. As a consequence, it is inevitable that creditors will employ a variety of different practices and procedures. We would anticipate that, in most cases, their specific knowledge of their part(s) of the credit market will mean that they should be well placed to judge the most appropriate approaches in their particular sector(s). However, the OFT would have concerns if it appeared to us that the means employed for assessing affordability by a particular business was inadequate and was contributing to borrowers being granted credit that they can not afford, resulting in, or appearing to us to be likely to result in, **adverse outcomes**¹⁰ for the borrowers concerned.
- 5.6 In short, we do not seek to prescribe through the Guidance the exact means by which creditors should assess affordability before granting credit to a borrower - it is the 'outcome' for the borrower that it is of most concern to us **in the first instance** rather than the process by which that outcome is achieved. However, where there appear to be adverse outcomes for borrowers, we will seek to identify whether these adverse outcomes can be partially or wholly attributable to some deficiency or failing in the assessment procedures adopted by the creditor.
- 5.7 The OFT would expect creditors, if challenged, to be able to demonstrate to our satisfaction that the methods that they employ to assess affordability are sufficient – including where the methods employed do not take income and/or expenditure into account.

¹⁰ While the OFT recognises that some categories of borrower, as a consequence of their financial circumstances, may be more **inclined** to default than others, we would have concerns about creditors employing modes of affordability assessment which simply regarded a certain level of default as '**acceptable**'. An affordability assessment should always involve a reasonable assessment of the 'risk' to the borrower who is seeking the credit.

- 5.8 If we find that failing to take income and/or expenditure into account in assessing affordability is leading to adverse outcomes, we will consider amending the position that we have taken thus far in our Guidance.

Open-end credit

- 5.9 A few business respondents to the consultation asked for further clarity in respect of the OFT's expectations as to how affordability could be assessed in respect of 'open-end' credit.
- 5.10 Paragraphs 4.5 and 4.6 of the Guidance state:

'We consider that all assessments of affordability should be based on the premise that the borrower should be able to repay the credit over the term. It is accepted that providers of open-end credit, where there is no fixed term, will be limited in their ability to be able to make an assessment of whether repayments might be met in a sustainable manner **over the whole life of the credit agreement** – but they should be able to make a reasonable assessment of sustainability **at the time the credit agreement is entered into** (and on the basis of reasonable assumptions regarding the likely duration of any drawdown). The creditor's assessment should have regard to the borrower's ability to pay off the maximum amount of credit available (equivalent to the credit limit) over a reasonable period of time.

The OFT cannot stipulate exactly what will constitute a 'reasonable period of time' for this purpose as this will vary from case to case depending on the circumstances of the borrower and the amount of the credit. However, in the OFT's view, in the case of running account credit, the borrower should be able to repay the credit on a timeline at least akin to that used for other forms of unsecured lending such as fixed sum personal loans, made for an amount equivalent to the credit limit. If there was no realistic likelihood, based on an affordability assessment, that a borrower would have been capable of paying off an outstanding balance within a reasonable period of time if he spent up to his credit limit, then we

are likely to consider this to constitute irresponsible lending on the grounds that the borrower has been provided with clearly inappropriate credit. The fact that a borrower may be able to 'service a debt' over many years simply by making minimum repayments does not, in our view, equate to being able to pay off a debt in a reasonable period of time.'

- 5.11 Paragraph 6.2 of the Guidance also states that the OFT would have concerns if a creditor fails to monitor borrowers' repayment records during the course of their credit agreements:

'Failing to monitor a borrower's repayment record.

The OFT considers that creditors should take appropriate action, including notifying the borrower of the potential risk of an escalating debt, and signposting the borrower to not-for-profit providers of free independent debt advice, when/if there are signs of apparent/possible repayment difficulties – for example, a borrower failing to make minimum required payments or making a number of consecutive small/minimum repayments or a borrower seeking to make repayments on a credit card account using another credit card.'

- 5.12 We would expect a creditor to re-evaluate a borrower's ability to continue to make repayments in a sustainable manner (in other words to re-assess affordability) and to take appropriate action (such as, for example, rescheduling repayments or considering revising the amount of the credit to be provided under the agreement) where, in particular, the creditor becomes aware of any material change in the borrower's financial circumstances.
- 5.13 While we would only expect creditors to take account of matters of which they are aware, we would expect them to take reasonable steps to obtain information where it appears that it may be relevant to an affordability consideration to do so. For example, if a borrower informs a creditor that he has lost his job (and consequently his primary source of

income), this is an event which is likely to have a material impact on the borrower's financial circumstances.

Meeting repayments in a 'sustainable manner'

5.14 Some business respondents considered that the Guidance needed to provide greater clarity as to what the OFT meant by the borrower being able to meet repayments in a sustainable manner. This has been addressed in paragraph 4.3 of the Guidance:

'The OFT regards 'in a sustainable manner' in this context as meaning credit that can be repaid by the borrower:

- without undue difficulty – in particular without incurring or increasing problem indebtedness
- over the life of the credit agreement or, in the case of open-end agreements, within a reasonable period of time
- out of income and/or available savings, without having to realise security or assets.'

Meeting repayments 'without undue difficulty'

5.15 Some business respondents considered that the Guidance needed to provide greater clarity as to what the OFT meant by the borrower being able to meet repayments without undue difficulty. This has been addressed in paragraph 4.4 of the Guidance:

'The OFT would regard 'without undue difficulty' in this context as meaning the borrower being able to make repayments (in the absence of changes in personal circumstances that were not reasonably foreseeable at the time the credit was granted):

- while also meeting other debt repayments and other normal/reasonable outgoings and
- without having to borrow further to meet these repayments.'

A 'reasonable period of time' to meet repayments

5.16 Some business respondents considered that the Guidance needed to provide greater clarity as to what the OFT thought constituted a reasonable period of time for the borrower to be able to meet repayments. This has been addressed in paragraphs 4.5 and 4.6 of the Guidance.¹¹

'Reasonably foreseeable'

5.17 Some business respondents considered that the Guidance (paragraph 4.7 of the draft guidance) needed to provide greater clarity as to what the OFT considered a creditor might reasonably foresee in terms of a future event that it should take into account in considering whether a borrower would be able to afford to meet repayments on a credit agreement in a sustainable manner.

5.18 The Guidance makes clear that the OFT would regard 'reasonably foreseeable' in this context as a future event that may impact on the borrower's ability to make repayments on a credit agreement in a sustainable manner which the borrower **knows** will occur and of which the creditor is, or should be,¹² **aware**. The example given in the Guidance is of a borrower, approaching retirement age, who knows that his disposable income will fall when he does retire. This would not necessarily preclude the borrower from being granted the credit being sought, but it is a relevant factor that it **may** be appropriate for the creditor to take into account when assessing affordability dependent on the nature of the credit being sought and subject to proportionality considerations. For example, it should not be a particularly relevant consideration that a borrower is due to retire in one year from the date

¹¹ See paragraph 5.10 of this document.

¹² Paragraph 4.10 of the Guidance states that the OFT would expect creditors to 'take reasonable steps' to obtain relevant information (see also paragraph 5.21 of this document).

of a payday loan being granted that is to be repaid by the borrower within 30 days.

- 5.19 We do not expect creditors to have to indulge in 'crystal ball gazing and/or speculation'. An example used in the Guidance is of a borrower who believes (at the time that he enters into the credit agreement) that there is a **risk** that he may be made redundant at some point in the future (perhaps because he is employed in a business sector where there have been a number of redundancies as a consequence of a downturn in the economic cycle) but he does not actually **know** that this will be the case. Under such circumstances we would not consider a fall in the borrower's future income to be 'reasonably foreseeable'. However, if borrowers are aware that such a risk exists, they would be wise to exercise some caution before entering into any substantive long-term credit commitment.
- 5.20 We have removed from the Guidance the reference to creditors taking account of 'wider economic changes' when considering reasonably foreseeable changes in future circumstances which might impact on a borrower's ability to make repayments in a sustainable manner since, on reflection, we accept that this **may**, to some extent, fall into the category of 'crystal ball gazing and/or speculation'.
- 5.21 Although we would only expect creditors to take into account reasonably foreseeable changes in the future circumstances of the borrower of which they are 'aware', we would expect them to take reasonable steps to avail themselves of relevant information about which they should be aware (again subject to proportionality considerations) before the credit agreement is made. However, as stated in paragraph 4.10 of the Guidance, we do not consider that the creditor could be held culpable under circumstances in which it made a reasonable request for information from the borrower, in order to inform its assessment of affordability, and the information provided by the borrower was substantively incorrect/untrue and the creditor (acting reasonably) was not aware of this.

Student Lending

5.22 In paragraph 4.6 of the draft Guidance it states:

'In certain limited circumstances (such as through a known fixed period of temporarily reduced income), it might be reasonable to grant credit that is not immediately affordable. However, under such circumstances, repayment periods should be agreed in advance and borrowers should not be penalised for not making repayments prior to the conclusion of the agreed term.'

5.23 This was built upon and added to in the Guidance (see paragraph 4.9), in part in response to the consultation:

'In certain limited circumstances (such as when it is **known** that there will be a fixed period of **short-term** temporarily reduced income and it is known when this period of reduced income (or no income) will end and what the approximate level of income will be at the end of this period), we consider that it **might** be reasonable to grant credit that, on the basis of an affordability assessment, is not **immediately** sustainable – provided that under such circumstances repayment periods are agreed in advance and borrowers are not penalised for not meeting initial repayments.

In our view, this limited exception would not apply where the fixed period of reduced income was likely to span an extended period – as might be the case, for example, **in respect of certain types of student loans.**'

5.24 The reference to 'certain types of student loans' is **primarily** intended to relate to credit provided to students which might facilitate an **unduly high level of consumption** of goods or services in respect of which repayments would not be sustainable. This is **not** intended to be a specific reference to student loans provided by Local Education Authorities ('SLs') or Government-backed Professional and Career Development Loans ('PCDLs') to fund higher/further education and to enhance career prospects.

5.25 It is not the altruistic objectives behind the granting of SLs and PCDLs that differentiates them from 'credit to facilitate consumption' from the point of view of considering irresponsible lending. As stated in the text box adjacent to paragraph 5.5 of the Guidance:

'In the OFT's view, considerations of the 'suitability of intended use' would not cover such matters as whether a borrower should or shouldn't seek credit to, for example, pay for a holiday (as opposed to seeking credit to pay for more obvious 'essentials') – subject to the type of credit being provided not being unsuitable for its intended use and an appropriate assessment of affordability being undertaken prior to granting the credit to the borrower.'

5.26 SLs and PCDLs can be differentiated from most other forms of consumer credit lending in terms of the extent of the in-built 'protections' for borrowers from an 'affordability' perspective. For example, it is our understanding that repayment of SLs is 'income contingent' and, once they have completed their studies, borrowers are only required to make repayments on earnings above £15,000 gross per annum. Unless/until this threshold is reached and maintained, the borrower is not required to make any repayments.

5.27 With regards to PCDLs, provided that the borrower meets the qualifying criteria,¹³ he has a right to claim deferment of repayment for up to 17 months - **with the borrower incurring no penalty**. This does not mean that creditors providing PCDLs are absolved from responsibility for undertaking an appropriate assessment of affordability, based on the information available to them at the time the granting of the PCDL is being considered (we appreciate that they cannot engage in 'crystal ball gazing' in terms of the likelihood of the borrower securing appropriate employment at the end of his period of study). However, the level of 'forbearance' applied by creditors in respect of PCDLs is consistent with the **general principles** outlined in paragraph 4.7 of the Guidance (see

¹³ For example, the borrower has no paid employment immediately after completing his further education studies or is receiving certain state benefits.

immediately below) in that, provided certain appropriate criteria are met, formal agreement can be reached between the borrower and the creditor to allow for deferment of the initiation of repayment without it having adverse consequences on the borrower's overall financial situation.

'The OFT would not necessarily consider repayments to be unsustainable simply because the borrower may miss an occasional payment as it falls due. However, under such circumstances, we would not expect creditors to:

- extend **formally** the duration of the agreement; that is to say, we would expect creditors to allow for missed repayments to be made up at a later date (within the original term of the loan or otherwise accommodated) or
- where the duration of the agreement is formally extended, increase the total amount payable to unsustainable levels or otherwise cause an adverse impact on the borrower's overall financial situation.'

5.28 We added a couple of footnotes (in August 2010) to paragraph 4.9 of the Guidance with a view to better clarifying our position with regards to student lending:

'In certain limited circumstances (such as when it is **known** that there will be a fixed period of **short term** temporarily reduced income and it is known when this period of reduced income (or no income) will end and what the approximate level of income will be at the end of this period), we consider that it **might** be reasonable to grant credit that, on the basis of an affordability assessment, is not **immediately** sustainable – provided that under such circumstances repayment periods are agreed in advance and appropriate forbearance is applied in respect of borrowers who may not be in a position to meet initial repayments.

This **might** include, for example, allowing for deferment of repayment or waiving penalties in certain circumstances.

In our view, this limited exception would be less likely to apply where the fixed period of reduced income was likely to span an extended period.

See subsection entitled 'Student Lending' in **OFT1107resp - Summary of responses to the consultation on 'Irresponsible Lending – OFT Guidance for Creditors**. The OFT does **not** consider allowing for the deferment of repayment of student loans provided by Local Education Authorities to constitute irresponsible lending. We similarly do not consider allowing for the deferment of repayment of Government-backed Professional and Career Development Loans to fund higher/further education and to enhance career prospects to constitute irresponsible lending (subject to appropriate assessments of affordability being carried out by the creditor before the credit agreement is made).

In our view, the same consideration is **less likely** to apply to other forms of lending to students – for example in respect of the provision of credit facilities which might facilitate an unduly high level of consumption of goods or services in respect of which repayments would not be sustainable. This is because such credit facilities are **less likely** to afford borrowers an equivalent level of in-built protection from an affordability perspective (including **the extent of the forbearance** applied to the pursuance of initial repayments) to that afforded by providers of SLs and PCDLs provided certain appropriate criteria are met.'

Self-employed

- 5.29 A small number of business respondents to the consultation contended that the 'self-employed' would not be able to provide evidence of income and that, therefore, it would not be possible to undertake an affordability assessment prior to granting them credit. As a consequence, the self-employed may be denied access to credit.

- 5.30 The OFT does not agree with the contention that it is not possible to undertake an appropriate affordability assessment of a self-employed person prior to granting him credit. Copies of accounts (and/or letters from accountants), tax returns, bank account details, credit reference files, paid and outstanding unpaid invoices, and income and expenditure forecasts, are amongst the tools/means - and clearly there are others - which creditors might choose to use to inform their affordability assessments.
- 5.31 As with any other form of affordability assessment, the OFT does not intend to prescribe exactly what form of assessment a creditor should undertake in respect of a self-employed person. Indeed, the most appropriate means could vary considerably dependent on a number of factors. For example, the type of information or evidence that a recently self-employed person might be able to supply to inform an affordability assessment may be significantly different to that supplied by a self-employed person with a business that has been established for some considerable time prior to the application for credit being made.
- 5.32 However, we would expect whatever means of affordability assessment adopted to be appropriate and proportionate and to allow for a reasonable assessment to be made of the ability of the borrower to meet repayments in a sustainable manner and without the borrower experiencing adverse consequences. It is our understanding that it is the current practice of some creditors to place sole reliance on 'historic' information (for example, accounts and tax returns from the previous financial year – which may be as much as 12 months out of date) in informing their affordability assessments. The OFT considers it very doubtful whether, in all cases, such information may provide a reliable basis for assessing whether the borrower can afford the credit that he is seeking at the time that he is seeking it.
- 5.33 Also, as stated in paragraph 4.15 of the Guidance:
- 'We do not consider self-certification of income would generally be sufficient in respect of significant long-term credit agreements, particularly those secured on property.'

Affordability is relative to a borrower's financial circumstances

5.34 A number of respondents, primarily consumer representatives but also a couple of business respondents, considered that the OFT had placed too much emphasis in paragraph 4.13 of the draft guidance on the likely impact of credit provision on a borrower, from an affordability perspective, being linked to the **actual amount** of the credit being provided. They suggested that the amount of credit being provided **relative to the borrower's financial circumstances at the time the credit is provided** was a more relevant and important consideration. The contention was that while a relatively large loan, in absolute terms, might be relatively easily affordable for a relatively wealthy borrower, a much smaller loan in absolute terms could be far less affordable for a borrower whose financial circumstances are far less favourable - and we agree with this contention.

5.35 Consequently, paragraph 4.16 of the Guidance states as follows:

'Whilst the OFT accepts, as a general principle from a proportionality perspective, that the level of scrutiny required for small sum and/or short-term credit may be somewhat less than for large sum and/or long-term credit, we consider that creditors should also take account of the fact that the risk of the credit being unsustainable would be directly related to the amount of the credit granted (and associated interest/charges etc.) relative to the borrower's financial situation.'

Debt consolidation

5.36 One business respondent to the consultation contended that adherence to the draft guidance might lead to the end of debt consolidation.

5.37 We have taken steps to better clarify the OFT position in the Guidance.

- 5.38 Paragraph 4.26 of the Guidance cites as a potential irresponsible lending practice :

'Granting an application for credit when, on the basis of an affordability assessment, it is known, or reasonably ought to be suspected, that the credit is likely to be unsustainable.

For example, when it is apparent that the borrower has insufficient disposable income (or alternative means of repayment) to be able to afford to keep up repayments in a sustainable manner.

In the OFT's view, this could include situations where the creditor is aware that the borrower only had sufficient disposable income to be able to make repayments that pay off interest on open-end credit but none of the capital.

A further example could be where a borrower is advised by a creditor to consolidate his existing debts under circumstances in which it is clear from the affordability assessment, or ought to be clear from such an assessment, that this is likely to lead to an unsustainably higher cost of credit in the longer term. In the OFT's view, under such circumstances, the borrower may be better and more appropriately advised to seek assistance in the first instance from a not-for-profit provider of free and impartial money advice.'

- 5.39 The above makes clear that, in the OFT's view, debt consolidation may not be appropriate- or suitable- for every borrower in all circumstances and that such considerations should be informed, at least in part, by the undertaking of an appropriate affordability assessment. As with other types of credit provision, the ability of the borrower to be able to meet repayments in a sustainable manner should be a key consideration, as should considerations relating to the total cost of credit to be repaid by the borrower.¹⁴

¹⁴ See text box adjacent to paragraph 4.27 of the Guidance

- 5.40 Paragraph 4.17 of the Guidance also makes clear that the OFT would normally expect a relatively high level of scrutiny to be undertaken during the course of an affordability assessment under circumstances where consideration is being given to consolidating unsecured debt into a secured debt.
- 5.41 Paragraph 3.13 of the Guidance also outlines certain **specific** features of a debt consolidation agreement (amongst other types of credit agreement) which the OFT considers should be incorporated into the pre-agreement explanation provided by a creditor to a borrower to help inform his borrowing decision:

'The features of the agreement which may operate in a manner which would have a significant adverse effect on the borrower in a way which the borrower is unlikely to foresee.'

Where applicable (and known to the lender and calculable), consolidating existing debts will involve the payment of higher interest rates and/or charges (increasing the total amount payable) and/or will increase the repayment period.

Where applicable, that the credit would be secured on the borrower's property.'

Increasing the total cost of credit

- 5.42 Paragraph 4.3 of the draft guidance states:

'The OFT would not necessarily consider repayments to be unsustainable simply because the borrower may miss occasional payments as they fall due, provided no punitive charges were imposed and the term of the loan is not extended; that is to say, allowance is made for repayments to be made up at a later date within the original terms of the loan.'

5.43 Paragraph 4.6 of the draft guidance states:

'In certain limited circumstances (such as through a known fixed period of temporarily reduced income), it might be reasonable to grant credit that is not immediately affordable. However, under such circumstances, repayment periods should be agreed in advance and borrowers should not be penalised for not making repayments prior to the conclusion of the agreed term.'

5.44 Amongst the questions arising in respect of the above, both individually and in respect of their collective application, was whether the OFT would consider it to be per se irresponsible lending for creditors to allow repayments to be rescheduled (for example in respect of a borrower, with a secured loan, who was experiencing repayment difficulties and facing the possibility of his home, on which the credit was secured, being repossessed) such as to allow for smaller individual repayments to be made over a longer period – even if this leads to the total cost of credit to the borrower being somewhat increased (given, for example, the interest charged).

5.45 We attempted to address the concerns expressed by making revisions to the draft guidance – in particular with regard to what is now paragraph 4.27 of the Guidance:

'Inappropriately encouraging borrowers to increase, aggregate or roll over existing debt to **unsustainable** levels.

In our view, this does not prevent creditors rescheduling repayments where a borrower is experiencing difficulty - allowing the borrower longer to pay off the debt - provided that this does not increase the total amount payable or otherwise impacts adversely on the borrower's overall financial situation.

It would also not preclude debts being consolidated under circumstances in which the borrower's overall financial position is not detrimentally effected; that is to say, the borrower's indebtedness does not become unsustainable or increasingly unsustainable.'

5.46 However, post publication of the Guidance, some businesses and/or their representatives continued to express similar concerns regarding, in particular, the wording 'provided that this does not increase the total amount payable.'

5.47 We considered that the use of the words 'inappropriately' and 'unsustainable' in paragraph 4.27 would make it apparent that the paragraph was not aimed at practices intended to help borrowers in difficulty to meet repayments in a more affordable manner. Nevertheless, we accept that the wording in the Guidance was open to potential misinterpretation – so we have made a slight amendment (in August 2010) to facility greater clarity:

'Inappropriately encouraging borrowers to increase, aggregate or roll over existing debt to **unsustainable** levels.

In our view, this does not prevent creditors rescheduling repayments where a borrower is experiencing difficulty - allowing the borrower longer to pay off the debt - provided that this does not increase the total amount payable to unsustainable levels or otherwise impact adversely on the borrower's overall financial situation.

It would also not preclude debts being consolidated under circumstances in which the borrower's overall financial position is not detrimentally affected; that is to say, the borrower's indebtedness does not become unsustainable or increasingly unsustainable.'

5.48 For the sake of consistency, we have also made a similar amendment, applying the same basic principle, to paragraph 4.7 of the Guidance:

'The OFT would not necessarily consider repayments to be unsustainable simply because the borrower may miss an occasional payment as it falls due. However, under such circumstances, we would not expect creditors to:

- extend **formally** the duration of the agreement; that is to say, we would expect creditors to allow for missed repayments to be made up at a later date (within the original term of the loan or otherwise accommodated) or
- where the duration of the agreement is formally extended, increase the total amount payable to unsustainable levels or otherwise cause an adverse impact on the borrower's overall financial situation.'

6 PRE-CONTRACTUAL ISSUES

Encouraging borrowers to seek independent advice before a credit agreement is made

- 6.1 A number of respondents suggested that as a consequence of capacity constraints, the free advice sector was already experiencing considerable difficulty in meeting the demand for its services.
- 6.2 While the OFT considers that the value to borrowers of the advice provided by Citizens Advice and many other not-for-profit providers of free debt advice is considerable, we accept that demand may exceed capacity to supply and that consequently, there are barriers to this element of the draft guidance being able to be realised in practice. Consequently, while we would still encourage borrowers to consider seeking appropriate advice prior to entering into a credit agreement, and creditors to signpost borrowers to such sources of advice where it appears appropriate to do so, we have removed the specific reference to this from the Guidance.

'Suitability' of credit products

- 6.3 While a number of consumer representative respondents were strongly supportive of the reference in paragraph 2.2 of the draft guidance to an OFT expectation that creditors would consider the **suitability** of credit products in light of the borrower's needs and circumstances, a similar number of business respondents expressed concerns. Amongst the views expressed by business respondents were that this risked taking creditors into the realm of 'advised sales' with the corresponding increase in cost and burden (particularly with regards to training of front-line staff operating at point of sale) that this would bring.
- 6.4 Some industry respondents also suggested that the words, 'suspects or ought to suspect when a product is clearly inappropriate' in paragraph 5.4 of the draft guidance, implied that a creditor would be required to undertake an assessment of the suitability of a particular credit product for a particular borrower in every case. It was further suggested that

when perceived elements of suitability are introduced into the lending decision, it becomes more difficult to subsequently evidence (if challenged) that the product provided was actually suitable- and/or the most suitable- for a particular borrower. However, many of the same respondents also stated that they agreed with the principle that a credit product which is **clearly inappropriate** should not be promoted to a borrower.

- 6.5 In our view, the issue of the suitability of credit products offered is a relevant consideration in assessing whether lending has been irresponsible or not. However, in doing so, it is important that the threshold is set in the right place. We do not consider that creditors should be required to operate in 'advised sales territory' as such and necessarily be expected to assess and/or advise- as to the **most** suitable credit product from a range of potentially suitable products for a particular borrower in each and every case. However, we would expect creditors **not to supply** credit products to borrowers which are **clearly unsuitable** for particular types of use. We consider this position aligns with that in section 55A (2)(a) of the Act as amended by the Regulations with regard to the provision of adequate explanations.
- 6.6 We have amended the relevant paragraph (now paragraph 5.5) in the Guidance and added further explanation in the adjacent text box with a view to providing greater clarity in respect of this issue:

'Promoting the sale of a particular credit product to an individual borrower under circumstances in which the creditor has reason to believe that the product is **clearly** unsuitable for that borrower given his financial circumstances and/or his intended use of the credit (if known).

For example, advising a borrower to take out a secured loan, or to replace or convert an unsecured loan to a secured loan, when it is clearly not in the borrower's best interests to do so at that time. Another example would be promoting a short-term loan product such as a payday loan, which would be expensive as a means of

longer term borrowing, as being suitable for supporting sustained borrowing over longer periods.'

- 6.7 On a related issue, some business respondents contended that it would not be possible for providers of a single credit product to consider the suitability of that product for a particular borrower. We do not agree. As already stated, our expectation is not that creditors will assess whether one product from a range of products is more suitable than another suitable product but rather whether features of a particular credit product render it unsuitable for its intended use by a particular borrower.

Disclosure of commission

- 6.8 One or two business respondents questioned the position taken by the OFT in paragraph 5.15 of the draft guidance, particularly with regard to the disclosure of any commission. Paragraph 5.15 of the draft guidance reads as follows:

'Failing to act in the best interests of a borrower by promoting the sale of a particular product, for business and/or personal gain, under circumstances in which the product is clearly inappropriate given the borrower's needs and personal circumstances.

Differential commission rates or volume over-riders should be offered only where these are justified in terms of the relative work involved and the amounts should be disclosed¹⁵ to the borrower.'

- 6.9 Some business respondents who commented on this issue took the view that the OFT position went too far in implying that creditors or their intermediaries had a 'fiduciary duty' to borrowers.

¹⁵ A footnote to paragraph 5.15 of the draft guidance states that 'the amount of any such commission should be disclosed **on request**'.

- 6.10 In part in response to comments received, the OFT's stated position was slightly revised in paragraph 5.5 of the Guidance:

'Promoting the sale of a particular credit product to an individual borrower under circumstances in which the creditor has reason to believe that the product is **clearly** unsuitable for that borrower given his financial circumstances and/or his intended use of the credit (if known).

We also consider that differential commission rates or 'volume over-riders', should be offered to brokers or other intermediaries marketing the creditor's products only where these are justified in terms of the relative work involved.

We further consider that the amount or likely amount of any commission should be disclosed by the broker or intermediary, on request by the borrower, in order that the borrower should be enabled to take a view as to whether there is likely to be any conflict of interest.'

- 6.11 In our view, from an irresponsible lending consideration perspective, it is important that creditors, brokers and/or other intermediaries act with 'impartiality' when considering (in particular) whether a credit product may be clearly unsuitable for a particular borrower. We consider a creditor or his representative, agent or business associate, promoting a clearly inappropriate credit product to a borrower, to be an irresponsible lending practice. If there is evidence that this has resulted entirely or in part as a consequence of the creditor, broker or intermediary, putting his own commercial interests or those of the business he represents ahead of the needs of the borrower, under circumstances in which he knew or ought to have known that this was likely to result in adverse outcomes for the borrower concerned, then it would seriously call into question the integrity of the person(s) concerned and his (their) fitness to continue to hold a consumer credit licence.
- 6.12 Under circumstances in which a borrower has concerns about the impartiality of the creditor, his representative, or business associate, it is

appropriate that he should be able to seek clarity/reassurance with regard to any 'commercial incentives' that may potentially impact on the impartiality of the business or person promoting the sale of a particular credit product to him before committing himself to enter into a credit agreement with- or via- that person.

- 6.13 In accordance with the 'general principles of fair business practice' outlined in Chapter two of the Guidance, in particular the principles relating to 'transparency' and the 'fair treatment of borrowers' as detailed in paragraph 2.3 of the Guidance, borrowers ought to be able to avail themselves of information relating to any commissions which might potentially have a material impact on the impartiality of those who are brokering- or seeking to provide- credit to them.
- 6.14 Under such circumstances, we would expect borrowers, upon request, to be provided with whatever they consider to be sufficient information to enable them to take an informed view on the impartiality or otherwise of the creditor, his representatives and/or other brokers or intermediaries and any consequential risk that the credit product being promoted to them may be unsuitable.
- 6.15 So, in summary, we consider that brokers should disclose to borrowers the **existence** of any commission or other payment payable by the creditor, and of any other reward available from the creditor, before the credit agreement is made with the borrower. The **amount or nature**¹⁶ of

¹⁶ In the case of **Yates and Lorenzelli v Nemo Personal Finance (Manchester County Court, 14 May 2010)**, the Court found that commission on the sale of PPI created an incentive for the broker to sell the product and so gave rise to a potential conflict of interest. The fact of the commission was disclosed in the accompanying documentation, but not the amount, and it was considered that the lack of transparency affected the way the customer might assess any advice given by the broker and his ability to make an informed choice.

any such commission should be disclosed **upon receipt of a request from the borrower** to do so.¹⁷

Mental capacity

- 6.16 A number of consumer representative respondents strongly supported the OFT seeking to address the issue of mental capacity limitations potentially impacting on a borrower's ability to be able to make the relevant financial/borrowing decision at the time that he enters into a credit agreement with a creditor.
- 6.17 A number of business respondents appeared unaware of existing legal obligations – appearing instead to believe that the OFT was introducing new requirements via its guidance. Other business respondents recognised and acknowledged that they had obligations towards borrowers who may lack mental capacity but were concerned about practical issues for their staff at point of sale in terms of:
- how they might go about identifying those individuals who may lack the requisite mental capacity at the time those individuals are required to make the relevant borrowing decision

¹⁷ This is in order that the borrower is clear as to any potential conflict of interest on the part of the broker. The OFT would **encourage** brokers to **proactively** disclose the amount or likely amount or percentage figure of the commission, since such transparency will help to reassure borrowers that they are receiving appropriate advice from the broker. In our view, if the rates of commission payable by the creditor vary between products, or according to the status of the borrower or for other reasons, this should be made clear to the borrower. We consider that any such differences in commission rates should reflect the differential costs incurred by the broker in arranging the loan, to the extent that such costs are ascertainable by the creditor. The OFT would discourage the use of 'volume over-riders', whereby the amount of commission payable to the broker in respect of a loan may depend upon the total volume of business brought to the creditor over a given period. We also consider that where such volume over-riders exist, this should be disclosed to the borrower by the creditor and/or the broker.

- how they would avoid insulting or embarrassing borrowers if seeking to establish whether they had the requisite mental capacity
- how they would avoid breaching anti-discrimination legislation
- how they might assess whether a particular borrower had the requisite capacity
- how they might ensure that they do not breach any Data Protection Act 1998 considerations.

6.18 Some business respondents also expressed concerns about the potential costs that they may incur (in terms of seeking expert advice and in providing staff training) in order to be able to address this issue of giving appropriate consideration to limitations in the mental capacity of some borrowers. One business respondent advised that while many creditors are accustomed to spotting unusual spending patterns, they are unlikely to have any expertise in relating those to potential mental capacity issues. Others suggested that the draft guidance appeared as if it might be somewhat at odds with current Money Advice Liaison Group ('MALG') guidelines which, it was contended to us, work on the premise that a creditor will take reasonable steps **only** if they have prior knowledge of a borrower's condition.

6.19 We consider this to be a very important issue in respect of which creditors need to be properly engaged in order to avoid lending irresponsibly in a way that could have significant adverse consequences for some borrowers. This is reflected in the extent to which this issue is covered in the Guidance.

6.20 The Guidance is not intended to create a whole series of new requirements/obligations for creditors in respect of these issues. Rather it seeks to raise awareness amongst creditors about this issue and about existing legal obligations to the extent that they may be applicable. It appears to us that many creditors may not have had appropriate regard to this issue to date.

- 6.21 However, both the OFT and specialist consumer representative organisations who are very familiar with these issues and relevant legal obligations, accept that these are not easy issues for creditors to deal with.
- 6.22 The first step is for creditors to take responsibility for ensuring that they and their staff familiarise themselves with any relevant legislative requirements as applicable in their particular jurisdiction (legislative requirements differ in different countries within Great Britain¹⁸).
- 6.23 Annex 4 of the Guidance is designed to assist creditors by providing general guidance as to the approach they may wish to consider taking with a view to ensuring compliance. However, this is just the first step so far as the OFT is concerned. We initiated a project in March 2010 designed to enable us to produce more detailed guidelines for creditors regarding the issue of mental capacity limitations in respect of borrowing decisions. We anticipate this project being completed in- or around- the first quarter of 2011.
- 6.24 We have also amended some of the wording relating to mental capacity in the Guidance in order to align it more closely with wording employed in the Mental Capacity Act 2005 Code of Practice. With regard to identifying those who may lack the requisite mental capacity to be able to make a particular financial decision at a particular time, we have amended the wording in the Guidance (see paragraph 5.6) relative to that in the draft guidance to indicate a 'higher threshold' at which we would expect creditors might be able to identify that it may be appropriate for them to undertake mental capacity considerations – that threshold being that 'it is known that the borrower may lack- or it is reasonably believed that he may lack-' the capacity to comprehend the information/explanation provided by the creditor to inform his borrowing decision at the time the information and explanation are provided.

¹⁸ See footnotes 28 and 43 in the Guidance and the text box adjacent to paragraph 7.13 of the Guidance.

6.25 In our view it is important that the OFT, consumer groups, business representatives and clinicians engage with each other in respect of this issue with a view to ensuring the best outcomes for borrowers without the imposition of undue or unrealistic burdens on creditors.

Incomplete applications for credit – unsigned agreements

6.26 A couple of industry respondents suggested that paragraph 4.26 of the draft guidance should not be included in the Guidance. This paragraph related to the provision of credit to a borrower in the absence of the creditor having established- or confirmed- that the credit agreement had been properly executed - including, for example, in the absence of having established that the credit agreement had been signed in the prescribed manner by both the debtor and by (or on behalf of) the creditor or owner in accordance with section 61(1)(a) of the Act. Some respondents considered that this would unduly impact on the provision of credit by distance means (for example, via the internet).

6.27 Whilst we understood some of the concerns expressed and the basis for a number of the contentions received, we considered that some contentions made by business respondents did not accurately represent the true position. For example, while it is the case that the Act has been amended such that improperly executed regulated agreements are no longer (as was previously the case) **per se unenforceable in all cases**,¹⁹ and they can now be enforced against a debtor – **but only if an order of the court is granted** – it is our understanding that this amendment to the Act does not represent some form of Parliamentary endorsement that it is acceptable for creditors to simply disregard section 61(1)(a) of the Act as a matter of business practice. Indeed, one could reasonably presume that if this was Parliament's intention, it would have repealed- or amended- section 61(1)(a) of the Act at the same time that it amended section 65.

¹⁹ Section 127(3) of the Act, which renders improperly executed (including unsigned) agreements per se unenforceable, continues to apply to agreements made before 6 April 2007.

- 6.28 It is also the case that, historically, some business representatives have lobbied the Government of the day to exempt those creditors they represent from the need to obtain a borrower's signature on a credit agreement (in accordance with section 61(1)(a) of the Act) in order for the agreement to be properly executed – to date without success.
- 6.29 One of the contentions made by business representatives in support of such an exemption is that where the credit agreement was subsequently found not to have been signed by the borrower (and hence not properly executed), it would be the **creditor** who would bear the 'risk' of being unable to enforce the credit agreement. However, given that agreements that have not been properly executed can now potentially be enforced if an order of the court is granted – and that this amendment to the law is in part in response to a business lobby that this should be the case – this suggests that some creditors, at least, may no longer be prepared to 'bear the risk' of unenforceability but rather would seek to transfer the risk to the borrower.
- 6.30 One industry respondent suggested that the OFT had simply 'ignored' previous business contentions on this issue. This is not the case. However, it is the case that the OFT does not agree with some of the contentions that have been made by businesses and their representatives with regard to this issue.
- 6.31 The general issue of the requirement for signatures on credit agreements has been considered by the (then) Government as recently as late 2009. In December 2009, BIS published the (then) Government response to the consultation on proposals for implementing the CCD:

'The majority of respondents agreed with the proposal to retain a signature and signature box on credit agreements. Nevertheless, several industry respondents considered BIS did not have the vires to require signatures, noting that the CCD did not require signatures and that there was 'nothing in either English or Scottish law of contract that requires signatures for credit agreements'. Some industry respondents also held that requiring signatures would place UK lenders at a competitive disadvantage with regard to cross-

border lending. This concern regarding the impact of the requirement on competition was also echoed by one industry respondent who considered that obtaining signatures could not only delay customer access to credit, but place those lenders who have to rely on the postal service at a competitive disadvantage. Other industry respondents considered that the requirement would 'limit innovation' and mean that the legislation would not be 'future-proofed'. By contrast, one enforcement agency considered the requirement for a signature helped focus the consumer's attention on the fact that it is a legally binding document, which should be read carefully and that the signature box should appear after the prescribed information to ensure the consumer had read it.

We do not propose any significant changes to the provisions in the CCA regarding the formalities concerning the conclusion of a regulated credit agreement. The requirement that a signature is required by both parties to the agreement remains, although the requirements concerning the signature box have been removed.'

- 6.32 Compliance with section 61A of the Act will be mandatory from 1 February 2011.²⁰ This requires that where a regulated Consumer Credit Agreement has been made, the creditor must give a copy of the **executed** agreement to the borrower or, if a copy of the unexecuted agreement, in identical terms to the executed agreement, has already been provided to the borrower, the creditor must inform the borrower in writing that the agreement has been executed. Therefore, if there is any doubt, the creditor will need to satisfy itself that the agreement **has** been executed (and be satisfied as to the date of execution). In accordance with section 189 of the Act, an 'executed agreement' means 'a document, **signed by or on behalf of the parties**, embodying the terms of a regulated agreement, or such of them as have been reduced to writing'. 'The parties' to the agreement are the creditor **and** the debtor.

²⁰ Section 61A of the Act doesn't apply to agreements secured on land unless the creditor or a credit intermediary has complied with or purported to comply with regulation 3(2) of the Consumer Credit (Disclosure of Information) Regulations 2010.

6.33 Ultimately we decided not to include the paragraph in the draft guidance regarding unsigned agreements in the Guidance. However, this decision was not as a direct consequence of any of the contentions made by respondents. During our own internal review of the Guidance we took the view that while a licensed creditor, which, **as a matter of business practice**, treated a credit agreement as being properly executed in the absence of having taken appropriate steps to establish that this was the case, **could** be engaging in a practice that had the potential to lead to- or contribute to- irresponsible lending for the purposes of section 25(2B) of the Act, such conduct more readily lent itself to simply being considered an 'improper practice'²¹ for the purposes of section 25(2A)(e) of the Act.

²¹ While we accept and acknowledge the legal right of creditors to seek to enforce unsigned credit agreements by order of the court in accordance with section 65 of the Act as amended, we would have **particular** concerns about a creditor, which as a matter of business practice, does not take appropriate steps to establish that its credit agreements have been signed by borrowers before treating them as having been properly executed, **and** transfers the risk resulting from such a business practice to the borrower.

7 CONTRACTUAL AND POST-CONTRACTUAL ISSUES

Variation in interest rates

- 7.1 Some industry respondents expressed the view that there was no need for the Guidance to address conduct issues relating to the variation of interest rates since such conduct was, at least in part, subject to certain legal requirements (for example under the Payment Services Regulations 2009) and it was also being addressed in the (then) draft Lending Code. However, given that, in our view, inappropriate conduct by creditors with regard to the varying of interest rates applied to borrowers could be relevant to considerations of their fitness to hold a consumer credit licence, it was necessary and appropriate, for the sake of greater transparency, for these issues to be covered in the Guidance.
- 7.2 One trade body respondent contended that variations of interest rates 'should not be based on objective tests alone as this fails to recognise the way in which the market is currently funded'. One of the consumer body respondents considered that the draft guidance did not go far enough in seeking to ensure 'fairness for consumers'.
- 7.3 Having considered the comments made by both business and consumer respondents, we have made some revisions to the elements of Chapter six of the Guidance pertaining to this issue. Our revisions also take account of the outcome- and recommendations- of the BIS Review of the Regulation of Credit and Store cards which was completed in mid-March 2010.
- 7.4 These matters are largely covered in paragraph 6.20 of the Guidance. This sets out the OFT's view of what may constitute a 'valid reason' for varying interest rates and the extent to which (in our view) Schedule 2 to the Unfair Terms in Consumer Contracts Regulations 1999 may be applicable to considerations pertaining to the varying of interest rates:

'Varying interest rates where there is no valid reason for doing so.

For example, in our view, variable rates should not be misused to take advantage of a borrower's lack of ability to end the

agreement, or restrictions on him doing so such as redemption charges.

'Valid reasons' may include:

- the recovery of genuine increased costs in lender funding or
- a change in the risk presented by a borrower such as to justify a change in the interest rate.

Schedule 2 to the Unfair Terms in Consumer Contracts Regulations 1999 (Statutory Instrument 1999 No.2083) identifies the following terms which may be regarded as unfair:

Terms which may have the object or effect of:

Paragraph 1(j) – enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract.

Paragraph 1(l) – providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded.'

- 7.5 We also state in paragraph 6.20 of the Guidance that we consider that it would be appropriate for a borrower to be given an explanation that applies to his individual circumstances when his rate has been increased on the basis of a 'risk assessment', in order that he might better understand what steps he can take to positively affect his own credit rating. We would expect the level of detail contained in such an explanation to be no more than is sufficient to enable the borrower to whom it is given to take a considered view on steps he might make to change his borrowing behaviour such that his 'risk rating' might subsequently and consequentially be reduced.

7.6 Many business respondents to the consultation contended that, as well as creditors taking steps not to lend irresponsibly, borrowers needed to take steps not to borrow irresponsibly. The provision of this type of information by creditors to borrowers should facilitate them being able to do so.

Charges

7.7 We have removed the reference from the text box adjacent to paragraph 7.14 in the draft Guidance (paragraph 7.15 in the Guidance) which states that charges should be proportionate to the debt to which they relate. Some respondents suggested that altering default charges in accordance with the sum owed under an agreement was both impractical and inappropriate. Having considered this matter further, we agree with the views expressed.

7.8 Paragraph 7.15 of the Guidance now reads as follows:

'Imposing unreasonable charges on borrowers in default or arrears.

In the OFT's view, any default or other charges should be transparent and limited to what is reasonable, doing no more than covering the creditor's reasonable costs.'

Rolling over existing loans/debts

7.9 Paragraph 2.3 of the draft guidance, which states that creditors should not encourage borrowers to increase, aggregate or roll over existing debt when borrowers may face difficulties clearing their debts, was one of the most strongly supported elements of the draft guidance in responses received from consumer representatives. Many considered the rolling over of short-term high interest loans to be a potentially major contributor to problem indebtedness amongst sub-prime borrowers.

7.10 However, a number of business respondents expressed some concern that, having regard to paragraph 2.3 of the draft guidance as drafted might impede some forms of debt consolidation lending- and/or deferred payment options which, under certain circumstances, might be beneficial

to borrowers experiencing problem indebtedness who were struggling to meet repayments.

- 7.11 Consequently, we revised the wording in the Guidance (see paragraph 6.25 of the Guidance) with a view to making it clearer that it was the refinancing or rolling over of short-term credit products in a way that is '**unsustainable or otherwise harmful**' that we considered may constitute irresponsible lending.²²

'Apparent repayment difficulties' and 'effectively monitoring repayment record'

- 7.12 A few business respondents requested some additional clarification regarding the OFT's use of the above phrases in the draft guidance.

- 7.13 In the textbox adjacent to paragraph 6.2 of the Guidance it states:

'The OFT considers that creditors should take appropriate action, including notifying the borrower of the potential risk of an escalating debt, and signposting the borrower to not-for-profit providers of free independent debt advice, when/if there are signs of apparent/possible repayment difficulties – for example, a borrower failing to make minimum required payments or making a number of consecutive small/minimum repayments or a borrower seeking to make repayments on a credit card account using another credit card.'

Credit and store cards

- 7.14 The draft guidance was issued prior to the BIS consultation on its review of the regulation of credit and store cards. Substantial additions were made to Chapter six (in particular) of the Guidance to reflect the contents of the agreement reached between the then Government and credit and store card providers which was publicised in mid-March 2010.

²² See also sub-section in this document entitled 'Increasing the total cost of credit' (paragraphs 5.42 to 5.48 inclusive).

- 7.15 The extent to which the elements of this agreement are covered in the Guidance reflects the importance that the then Government placed on this review and the importance of securing the right outcomes for borrowers.
- 7.16 Failure by a creditor (or any other licensed business) to adhere to the terms of an agreement reached with Government (previous or current) would clearly be relevant to considerations of fitness to hold a consumer credit licence.

8 HANDLING OF DEFAULT AND ARREARS

Irresponsible Lending Guidance and the Debt Collection Guidance

- 8.1 Some business respondents expressed some uncertainty regarding the relationship between the OFT's Irresponsible Lending Guidance and Debt Collection Guidance.
- 8.2 As stated in the foreword to the Guidance, the primary purpose in producing it is to provide greater clarity for businesses and consumer representatives as to the business practices that the OFT considers may constitute irresponsible lending practices for the purposes of section 25(2B) of the Act.
- 8.3 Section 25 (2B) of the Act makes it explicit that amongst the business practices which the OFT may consider to be deceitful or oppressive or otherwise unfair or improper, for the purposes of section 25 of the Act, are practices in the carrying on of a **consumer credit business** that appear to the OFT to involve irresponsible lending.
- 8.4 As defined in section 189 of the Act, 'consumer credit business' means any business being carried on by a person so far as it comprises or relates to the provision of credit by him, or otherwise his being a creditor, under regulated consumer credit agreements. 'Creditor' means the person providing credit under a consumer credit agreement or the person to whom his rights and duties under the agreement have passed by assignment or operation of law, and in relation to a prospective consumer credit agreement, includes the prospective creditor.
- 8.5 The Guidance also states that references to 'creditors' and 'consumer credit businesses', throughout the Guidance, are also generally applicable to their employees, agents or associates and Annex 3 of the Guidance covers the OFT's view of the extent of the creditor's responsibility for conduct of agents and third parties:

'The OFT considers that creditors should take **appropriate** responsibility for acts or omissions of brokers, debt recovery

businesses (DRBs) and other intermediaries or agents involved in the lending process.

The OFT considers third party debt collection businesses that recover debts on behalf of creditors may be business associates and/or agents of the creditors on whose behalf they act. DRBs to whom creditors have assigned debts may themselves become the 'creditor' under the agreement.'

- 8.6 The Irresponsible Lending Guidance (in particular Chapter seven on the 'Handling of Default and Arrears) takes account of matters relevant to debt collection and recovery practices, such as OFT market experience, relevant legislative reform, relevant Government initiatives and development of relevant codes of practice and protocols – some of which post date the last update of the Debt Collection Guidance in December 2006.
- 8.7 We currently anticipate that an updated version of the Debt Collection Guidance is likely to be issued in autumn 2010 which will be aligned, to the extent that it is appropriate to do so, with the relevant aspects of the Guidance. The OFT position has always been that licensed businesses should have regard to all relevant OFT Guidance. So, in the interim period at least, we would expect those seeking to recover debts to have regard to both the Debt Collection Guidance and the Irresponsible Lending Guidance.

Charging orders, orders for sale and inhibitions

- 8.8 A small number of business respondents questioned whether the OFT should be considering the issue of seeking charging orders and/or orders for sale in an irresponsible lending context given that they were to be the subject of a Government consultation and were already the subject of an ongoing OFT review.
- 8.9 The OFT review is largely focused on the extent to which charging orders and orders for sale are being applied for by creditors, the

circumstances that lead to such applications being made and any consequential (adverse) outcomes for borrowers²³. The findings of this review will not impact on the OFT's general position with regard to the use of these 'instruments', which is as stated in the Guidance:

'The OFT would not expect a creditor to take disproportionate action against borrowers in respect of arrears or default. This would include such matters as applying to the court for an order for sale or for the borrower to be made bankrupt, without having explored other alternative, more proportionate options for recouping arrears.

In the OFT's view, it would not be disproportionate for creditors to apply for charging orders (or inhibitions in Scotland) against a borrower's home as a means of securing arrears owed to them. However, we would consider it to be an unfair and irresponsible lending practice for creditors to use the **threat** of court action followed by a charging order (or inhibition) to intimidate borrowers in financial difficulties to pay more than they could reasonably afford.

We consider that other possible options for dealing with the problem should be explored prior to resorting to taking steps to repossess the borrower's property and that proper consideration should be given to any reasonable offer by the borrower to pay by instalments.

²³ The OFT is monitoring the use of 'charging orders' as a method of enforcing judgment debts, where the debts originally arose under regulated consumer credit agreements. The interim results of this review indicate that there may be potential problems with the way in which some creditors use charging orders as part of their debt enforcement activities. The OFT will be working with licensees to ensure that borrowers are not the subject of what we would consider unfair business practices in relation to the use of charging orders and orders for sale. At the time of writing, it is anticipated that the final results of the review will be published in Autumn 2010.

The OFT would further expect second charge lenders in England and Wales to have regard to the requirements of the Pre-action Protocol for Possession Claims Based on Mortgage or Home Purchase Plan Arrears in Respect of Residential Property (PAP) as set out by the Civil Justice Council in October 2008. The aims of the PAP are to ensure that a lender and a borrower act fairly and reasonably with each other in resolving any matter concerning arrears, and to encourage more pre-action contact in an effort to seek agreement between the parties on alternatives to repossession. The Pre-action Protocol on Possession Proceedings applies to all mortgage repossession cases in Northern Ireland. The Home Owner and Debtor Protection (Scotland) Act 2010 provides for pre-action requirements to be placed on secured lenders in Scotland.'

- 8.10 It is also the case that in February 2010, the Ministry of Justice launched a consultation seeking views on whether a minimum threshold should be imposed on orders for sale applications relating to Consumer Credit Act 1974 debts only. In announcing its 'programme for Government' in May 2010, the Government stated that it would 'provide more protection against aggressive bailiffs and unreasonable charging orders, ensure that courts have the power to insist that repossession is always a last resort, and ban orders for sale on unsecured debts of less than £25,000.'
- 8.11 Our Guidance will of course be amended, as and when appropriate, to reflect any legislative reforms, when they are due to come into force, in respect of these or any other relevant matters.

Breathing space

- 8.12 Paragraph 7.11 of the draft Guidance relates to the provision of 'breathing space' to borrowers in default or arrears under circumstances in which a not-for-profit debt advisor (such as, for example, a Citizens Advice debt advisor) is assisting the borrower in agreeing a repayment plan with the creditor or any third party or agent acting on behalf of the creditor. Some respondents considered that the scope of this element of

the draft guidance ought to be extended to circumstances when the borrower was being assisted in developing a repayment plan by a profit-seeking debt advisor or, indeed, when the borrower was developing an appropriate repayment plan of his own accord, without any external assistance.

- 8.13 Having considered this matter, we have formed the view that the principle of creditors and/or those acting on their behalf exercising appropriate forbearance by allowing borrowers reasonable time to develop appropriate repayment plans should apply – regardless of whether the borrowers are doing so in concert with a profit-seeking or non-profit seeking debt advisor, or without any active assistance from others.
- 8.14 It would be inconsistent (and indeed, somewhat irrational) for the OFT to take the view that not allowing a borrower, with a genuine commitment to developing an appropriate repayment plan in concert with a profit-seeking debt advisor or without any active outside assistance, a reasonable period of time to do so, would not constitute an irresponsible lending practice.
- 8.15 One could envisage a situation where a borrower may initially seek the assistance of a not-for-profit debt advisor in his local area in developing a repayment plan only to find that no such assistance was immediately available (perhaps because the limited resources available in his locality are already over-stretched), leading to the borrower, alternatively, seeking the assistance of a profit-seeking debt advisor. Clearly, under such circumstances, it would not be appropriate to 'penalise' the borrower by not allowing him a reasonable period of time to develop an appropriate repayment plan.
- 8.16 Similarly, if a borrower has the financial capability (using 'self-help aids' or otherwise) to develop an appropriate debt repayment plan himself, without any active assistance or advice from others (and in doing so, he would be placing less pressure on the finite resources available to assist those who would need the help and advice of others in this regard), it

would again not be appropriate to penalise him by not allowing him a reasonable period of time to do so.

- 8.17 Consequently, the OFT's position is reflected in the wording of the irresponsible lending practice identified in paragraph 7.12 of the Guidance and the associated text box:²⁴

'Failing to suspend the active pursuit of recovery of a debt from a borrower in default or arrears difficulties for a reasonable period under circumstances in which it can be evidenced that a debt advisor is assisting the borrower in agreeing a repayment plan.

The Credit Services Association committed to Government in 2009 that its members would not contact debtors to pursue debts for 30 days, as soon as they have been informed that a debt advisor has taken on the case on behalf of the borrower, with a view to allowing the debt advisor to negotiate with creditors and/or any third party debt recovery businesses so that a plan for repaying the debt can be agreed.

A similar commitment to provide borrowers with 'breathing space' was provided by relevant creditors at the Credit Card Summit in December 2008.

Similar breathing space should be extended to a borrower where it can be evidenced that he is developing a plan on his own account for repaying the debt; that is to say, without the assistance of a debt advisor.'

- 8.18 The OFT position does not **explicitly** extend the '30 day breathing space' agreements reached between creditors and Government at the Credit Card Summit in December 2008 and between the Credit Services Association and Government in 2009. However, it makes clear that the

²⁴ This wording was slightly revised in August 2010, taking account of comments and representations made.

OFT would expect that the **principle** that underpinned both agreements – that being that borrowers making a genuine attempt to develop an appropriate repayment plan ought to be permitted a reasonable period of time to do so – should be observed by creditors or those acting on their behalf, who are seeking to recover debts owed, regardless of whether the borrowers are receiving any assistance from debt advisors to do so and/or regardless of the specific 'status' of any such debt advisors.

- 8.19 Under circumstances in which debtors or those assisting them to develop an appropriate repayment plan do request a reasonable period of time to develop such a plan, we do not consider that it would be unreasonable for creditors or those acting on their behalf to seek some sort of reassurance- or evidence- that a genuine attempt is being made to develop a repayment plan and that the request for additional time is not simply part of an overall intention to avoid- or delay- paying a debt duly owed. For example, the contact details of a for-profit debt advisor who could confirm that he is actively engaged with the borrower in seeking to develop a repayment plan, or early drafts of a repayment plan being produced by a borrower seeking to develop such a plan of his own accord without any outside assistance, might suffice.

Right of set-off

- 8.20 A couple of respondents suggested that the Guidance should outline the OFT position in respect of right of set-off from an irresponsible lending perspective. Paragraph 7.19 of the Guidance states:

'Exercising a right of 'set-off' without undertaking an associated affordability assessment or under circumstances in which such an assessment has been undertaken and it is clearly apparent that the borrower is already experiencing an unsustainable level of indebtedness or would be if a right of set-off is exercised.

The 'Right of Set-Off' is the process whereby banks exercise their common law right to apply a customer's credit balance in one account against unpaid or overdue amounts on other accounts in that customer's name. For example, this could be where a bank

takes funds from a customer's current account to cover a missed credit card payment.

The Lending Code (monitored and enforced by the Lending Standards Board) sets minimum standards of good practice that banks, building societies and credit card providers should follow when dealing with retail customers. The OFT agrees with the position as stated in guidance issued by the Lending Standards Board that before applying set-off, businesses should take account of information that they have available to them to identify whether the borrower may be in- or may be heading towards- financial difficulties. In all cases where set off is to be applied and it has been established, by the creditor, that the borrower is in financial difficulties, the customer should be left with sufficient money to meet their reasonable day-to-day living expenses and priority debts, where these have been identified. Particular care should be taken where it can be identified that a borrower's balance is made up wholly or in part of state benefits.'

9 REGULATORY COMPLIANCE

Evidencing adherence to the Guidance – audit trails

- 9.1 The main focus of the comments received in respect of chapter eight of the draft guidance related to OFT expectations in terms of creditors evidencing 'compliance' with the Guidance. In particular, business respondents were keen to avoid what they perceived as the cost, resource, and/or administrative burden of maintaining documented audit trails with a view to better evidencing (for example, that they had provided adequate explanations to a borrower, prior to a particular credit agreement being made) that they have had full regard to the relevant aspects of the Guidance including compliance with the relevant legal requirements.
- 9.2 In order to be able to be granted- or to continue to hold- a consumer credit licence, the OFT needs to be satisfied that the person/business is fit to do so. This may require a creditor to evidence to the OFT's satisfaction that it:
- has a defined policy with regard to the practices and procedures that it follows with a view to ensuring that it does not engage in irresponsible lending
 - it gives effect to these practices and procedures and that
 - these practices and procedures are effective.
- 9.3 We have taken account of the concerns expressed by industry representatives and, as a consequence, we have not been overly prescriptive in terms of stating what we would specifically expect all creditors to provide us with, in all cases, in order to satisfy us that they are giving effect to appropriate practices and procedures. Instead, we have left it to individual creditors to decide the most appropriate means for them to employ. However, whatever means adopted must be

sufficient to be able to satisfy us of the licensee's fitness in this regard.²⁵

- 9.4 Ultimately, what will **initially** be most important to us when considering the practices and procedures employed by creditors with a view to ensuring that they don't lend irresponsibly, will be **the outcomes for borrowers**. The particular practices and procedures employed by the creditor that resulted in those outcomes arising will be more likely to be of interest to us where we identify **adverse outcomes for borrowers**.
- 9.5 For example, a high level of loans in default or arrears **might** suggest that the practices and procedures employed by the creditor in question are inadequate in terms of taking account of whether borrowers might be able to meet repayments on the credit provided in a sustainable manner – but this may not be the case. Some creditors may tend to provide credit to borrowers who may be particularly vulnerable to 'unexpected income shock' and for whom, consequently, any relatively small change in circumstances could have significant consequences in terms of the ability of such borrowers to sustain repayments on credit provided.
- 9.6 Consequently, if the OFT has concerns about the levels of default and arrears associated with particular creditors, we will start from the position of looking at the 'outcome' and then work backwards from that point with a view to deciding whether the observed adverse outcomes for borrowers are, at least in part, a consequence of any deficiencies in the practices and procedures employed by the creditor, or wholly a consequence of some form of income- or other financial- shock that the creditor could not have known about or reasonably anticipated²⁶ based on the information that it has in its possession and/or that it should have

²⁵ We do consider that, in some circumstances, it **may** be more difficult for creditors to satisfy the OFT in this regard in the absence of well documented audit trails. We also consider that the maintenance of such audit trails may also facilitate creditors being able to rebut vexatious assertions by borrowers or their representatives that they have been the subject of irresponsible lending practices as a consequence of the actions of the business.

²⁶ See Chapter four of the Guidance.

ensured that it had in its possession prior to making the credit agreements with the borrowers in question.

Publication of creditors' lending policies and procedures

- 9.7 Some consumer bodies considered that the OFT should **require** creditors to publicise, on their web-sites or elsewhere, their policies and procedures as applied to regulated consumer credit lending. They considered that this would not represent an undue burden on businesses and would facilitate borrowers and/or their representatives better being able to identify if creditors were either employing inappropriate practices and procedures and/or failing to give effect in practice to their published practices and procedures. It was also suggested that this might better enable more responsible creditors to gain a competitive advantage over their rivals.
- 9.8 The primary purpose of the guidance is to provide clarity for creditors as to the OFT's view on what might constitute irresponsible lending for the purposes of section 25(2B) of the Act. We have statutory powers under sections 36B and 36C of the Act which enable us to require creditors to provide us with details of their practices and procedures, enabling us to take a view as to their appropriateness or otherwise and as to whether these practices and procedures are being given effect to. In exercising these powers, we would primarily be informing our view as to the creditor's fitness to hold a consumer credit licence rather than seeking to identify practices, which if conducted in isolation, might call into question the validity of individual agreements.
- 9.9 Consequently, while we would **encourage** creditors to be open and transparent with borrowers as to the practices and procedures they employ with a view to ensuring that they do not engage in irresponsible lending, we are not empowered to impose such a blanket requirement on all creditors even if we wished to do so. We consider that such transparency is more of an issue of 'best practice' for creditors rather than the minimum standard that should be expected of all creditors.

9.10 It is also the case that some elements of the policies and procedures employed by creditors to inform their lending decisions may constitute 'business secrets'. While it may be reasonable for the OFT to require such information to be provided in confidence to inform its 'fitness assessment' of the business, it would, in our view, be unreasonable for such confidential information to have to be made publicly available such that it could be readily accessed by competitors.

ANNEX A

LIST OF CONSULTATION QUESTIONS

CHAPTER 1

- Q1 Does the introductory chapter set out the OFT's general view on the scope of what might constitute irresponsible lending practices, and the legal test for irresponsible lending, sufficiently clearly?
- Q2 Are there any substantive aspects with which you disagree?
- Q3 Do you consider that there are any significant omissions?
- Q4 Do you have any other suggestions for improvement?

CHAPTER 2

- Q5 Are the draft guidelines on the general principles of lending sufficiently clear?
- Q6 Are there any substantive aspects with which you disagree?
- Q7 Are there any significant omissions?
- Q8 Do you have any other suggestions for improvement to this section?

CHAPTER 3

- Q9 Are these draft guidelines on explanations of credit products sufficiently clear?
- Q10 Are there any substantive aspects of the draft guidelines on explanations of credit products with which you disagree?
- Q11 Are there any significant omissions?
- Q12 Do you have any other suggestions for improvement to this section?

- Q13 Where applicable, should borrowers be able to access telephone 'help-lines' free of charge?
- Q14 Where applicable, should creditors be required to provide access to telephone 'help-lines' at point of sale?
- Q15 Where a borrower has entered into a long-term credit agreement, should the creditor be required to repeat aspects of the explanation of the credit product during the term of the agreement and, if so, how frequently?

CHAPTER 4

- Q16 Are these draft guidelines on assessment of affordability issues sufficiently clear?
- Q17 Are there any substantive aspects of the draft guidelines on assessment of affordability issues with which you disagree?
- Q18 Are there any significant omissions?
- Q19 Do you have any other suggestions for improvement to this section?

CHAPTER 5

- Q20 Are the draft guidelines on pre-contractual issues sufficiently clear?
- Q21 Are there any substantive aspects of the draft guidelines on pre-contractual issues with which you disagree?
- Q22 Are there any significant omissions?
- Q23 Do you have any other suggestions for improvement to this section?

CHAPTER 6

- Q24 Are these draft guidelines on post-contractual issues sufficiently clear?
- Q25 Are there any substantive aspects of the draft guidelines on post-contractual issues with which you disagree?

Q26 Are there any significant omissions?

Q27 Do you have any other suggestions for improvement to this section?

CHAPTER 7

Q28 Are these draft guidelines on the handling of default and arrears sufficiently clear?

Q29 Are there any substantive aspects of the draft guidelines on the handling of default and arrears with which you disagree?

Q30 Are there any significant omissions?

Q31 Do you have any other suggestions for improvement to this section?

Q32 Should a debt recovery business delay pursuance of a debt from a borrower lacking the capacity to make decisions relevant to the debt recovery process, unless the borrower has someone managing his affairs pursuant to a Lasting Power of Attorney or an order of the Court of Protection?

CHAPTER 8

Q33 Are these draft guidelines on regulatory compliance and enforcement sufficiently clear?

Q34 Are there any substantive aspects of the draft guidelines on regulatory compliance and enforcement with which you disagree?

Q35 Are there any significant omissions?

Q36 Do you have any other suggestions for improvement to this section?

ANNEX B

LIST OF RESPONDENTS

1. Action for Business Limited
2. Advertising Standards Authority
3. American Express
4. Anthony Sharp Associates
5. Association of British Credit Unions Limited
6. Association of Finance Brokers
7. Association of Short Term Lenders
8. Bank of America (MBNA Europe Bank Limited)
9. Banking Code Standards Board
10. Barclays
11. Birmingham Trading Standards
12. BMW Financial Services Group
13. Brighthouse
14. British Bankers Association (BBA)
15. British Cheque and Credit Association
16. British Retail Consortium
17. Building Societies Association
18. Buy as you view
19. Callcredit
20. Capital One

21. Charities Aid Foundation
22. Church of England Diocese of Ripon and Leeds
23. Citizens Advice
24. Citizens Advice Calderdale Halifax
25. Citizens Advice Northern Ireland
26. Civil Court Users Association
27. Clydesdale Bank PLC
28. Community Development Foundation
29. Consumer Credit Association
30. Consumer Credit Counselling Service
31. Consumer Credit Trade Association
32. Consumer Finance Association
33. Consumer Focus
34. Council of Mortgage Lenders
35. Credit Services Association
36. Debt on our Doorstep
37. Development Trusts Association
38. Direct Marketing Association
39. Equifax
40. Finance and Leasing Association
41. HSBC Bank
42. Institute of Credit Management

43. Institute of Islamic Banking and Insurance
44. Kirklees Council
45. LACORS
46. Local Better Regulation Office
47. London Citizens
48. Lloyds Banking Group
49. Manchester City Council
50. Mind
51. Money Advice Trust
52. Mr & Mrs Hoey
53. Mr Jeremy Sutcliffe
54. Mr & Mrs Ross
55. Mr Webb
56. National Australia Group Europe Limited
57. National Pawnbrokers Association
58. Nationwide
59. Newlon Fusion
60. Paymex
61. Royal Bank of Scotland
62. Santander
63. Sheffield City Council
64. Stockport Borough Council

65. Sun Lane Limited
66. Tesco Bank
67. The Advertising Association
68. The CBI
69. The Methodist Church
70. The Oastler Centre
71. The UK Cards Association
72. Trading Standards Institute
73. Trading Standards North West
74. Urban Forum
75. Westcot
76. West Yorkshire Community Chaplaincy Project
77. Which?
78. Wonga.com