



OFFICE OF FAIR TRADING

Non-status Lending

Guidelines for lenders and brokers

Revised November 1997

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NON-STATUS LENDING GUIDELINES FOR LENDERS AND BROKERS

Revised November 1997

A NOTE BY THE DIRECTOR GENERAL OF FAIR TRADING

- i On 18 July 1997 I issued guidelines for lenders and brokers in the non-status lending market - also referred to as the sub-prime or impaired credit market. I am now issuing an expanded and clarified version of those guidelines, taking into account comments received on the earlier version. The substance of the guidelines remains largely unchanged.

- ii As before, the guidelines apply to **secured lending to non-status borrowers** - those with impaired or low credit ratings and who would find it difficult generally to obtain finance from traditional sources on normal terms and conditions. The guidelines highlight some of the main practices in this market which I consider to be deceitful or oppressive, or otherwise unfair or improper, within the meaning of section 25(2)(d) of the Consumer Credit Act, and which would be likely to lead me to take regulatory action against those involved. They also provide examples of good practice which I consider that lenders and brokers should seek to adopt. Most of the practices are not new, and my Office has issued warnings in the past, including in 1990 and in February this year. A number of the issues were also raised in the Office's report on *Unjust Credit Transactions* in September 1991.

- iii Although the guidelines apply only to secured lending to non-status borrowers, I 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.

The legislation

- iv Although mortgage lending is not subject to regulation under the Financial Services Act, a licence is required under the Consumer Credit Act to engage in a credit business or ancillary credit business. The majority of lenders involved in secured lending to non-status borrowers are licensed under the Consumer Credit Act to enable them to enter into regulated consumer credit agreements (where the amount of credit

does not exceed the limit prescribed from time to time in regulations¹). Their fitness to hold a licence may be brought into question by evidence of unfair business practices even where these arise in relation to unregulated credit business or any other business. Most brokers and other intermediaries engaged in the marketing of non-status loans are required to be licensed for the business of credit brokerage, regardless of the amount of credit involved.

- v I have a duty under the Consumer Credit Act to satisfy myself that applicants for licences are fit to engage in the activities for which they wish to be licensed, and to monitor the continuing fitness of those to whom licences have been granted. In considering fitness, I am able to take account of any circumstances which appear to be relevant, and in particular, among other matters, any evidence that an applicant or licensee, or any of its employees, agents or associates, has engaged in business practices appearing to me to be deceitful or oppressive or otherwise unfair or improper (whether unlawful or not). Where my Office has evidence of such practices I can and do take action to refuse or revoke the consumer credit licences of those concerned.
- vi I also have a general duty under the Act to keep under review social and commercial developments relating to the provision of credit, and related activities, and from time to time to advise the Secretary of State. I must also monitor the working and enforcement of the Act and any orders and regulations made under it.

Previous warnings

- vii On 24 October 1990 the then Director General issued a press release entitled *Credit Firms Warned on Loans to Non-Status Market*. This followed warning letters to businesses marketing credit to those with serious debt problems. The letters listed examples of practices which the Director General regarded as unacceptable and which put at risk the holding of a consumer credit licence. These included failure to assess ability to pay, offers of inappropriate and sometimes catastrophic loans, and failure to explain that high brokerage fees could be charged and deducted from the loan. An earlier press release on 27 March 1990 warned financial intermediaries of the risk of licensing action if they took part in undesirable activities connected with the sale of council houses under the Government's 'Right to Buy' scheme.
- viii In September 1991 the Office published a report entitled *Unjust Credit Transactions*. This made a number of recommendations aimed at reforming and developing sections 137-140 of the Consumer Credit Act, including replacing the concept of an 'extortionate credit bargain' with that of 'unjust credit transaction', and adding as factors in determining whether a transaction was unjust whether it involved excessive

¹ The current limit is £15,000.

(as opposed to grossly exorbitant) payments and the lender's care and responsibility in making the loan including the steps taken to find out and check the borrower's credit-worthiness and ability to meet the full terms of the agreement.

- ix The report noted that there was particular concern about abuses affecting the secured lending market where non-status borrowers - those with poor credit-worthiness - were induced to borrow on excessive or oppressive terms against the security of their homes without regard to their ability to repay the loan. The report identified examples of practices which would point towards an unjust credit transaction. These included marketing loans explicitly at those in debt; limited or no enquiries about income; pre-occupation with the value of the security rather than the borrower's credit-worthiness ('equity lending'); brokers' or other advance fees, often substantial, which were not fully disclosed or explained; very high interest rates; and increasing interest when a loan was in arrears, sometimes in breach of section 93 of the Act. They also included breach of the broker's duty to act in the best interests of the borrower; illegal canvassing of agreements in consumers' homes; irregular documentation including failing to give or misquoting interest rates and APRs; improper tying-in of insurance; falsifying information as to borrowers' income or other aspects of their financial status; misrepresentation as to the form, nature, purpose or long-term implications of loan agreements; and unacceptably high-pressure selling techniques.

- x On 20 February 1997 I issued a press release entitled *Warning to Lenders and Brokers*. This arose as a result of complaints to my Office about the business practices of a number of lenders and brokers in the non-status lending market. These included claims that consumers were being persuaded to take out loans beyond their ability to repay, with insufficient information being provided and insufficient time allowed to consider the agreement before signing. I expressed strong concern regarding such practices, and warned that firms risked losing their consumer credit licences if they were found to have misled borrowers or to have behaved unfairly. I also expressed concern about certain other practices including the charging of a dual rate of interest with a much higher rate being payable in the event of default on a payment; the use of the Rule of 78 for the early settlement of loans; the charging of high up-front fees and commissions which were not properly disclosed to the borrower; and the failure of brokers to disclose that they were tied to a lender and so could not offer best advice about a loan.

The July guidelines

- xi On 18 July 1997 I issued guidelines for lenders and brokers in the non-status lending market. These were intended to provide detailed guidance to firms on the kinds of business practice that should be avoided if their fitness to hold a consumer credit licence was not to be brought into question. Many of the practices highlighted in the guidelines were clearly deceitful or oppressive, or otherwise unfair or improper, and a

number had already been referred to in the February press release and in the earlier warnings and the *Unjust Credit Transactions* report. In those cases firms should have been aware, even before the issue of the guidelines, of the risk of licensing action if they engaged in such practices or encouraged or permitted their employees, agents or associates to do so. In other cases the position might have been less clear, and the guidelines were intended to be helpful to firms in outlining the kinds of business practice which the Office wished to encourage and those to which it was likely to object on the grounds of detriment to consumers.

- xii The Unfair Terms in Consumer Contracts Regulations 1994 also apply to loan agreements entered into on or after 1 July 1995, when the Regulations came into force. A term to which the Regulations apply shall not be binding on the consumer if it is unfair, and a term may be unfair if contrary to the requirement of good faith it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.

The revised guidelines

- xiii I made clear in the July guidelines that I expected all lenders and brokers in the non-status lending market to take full account of the guidelines, and to implement any necessary changes in their contract terms and conditions and practices as soon as reasonably practicable. I intended to write to lenders and brokers during September to ask what action they had taken and to satisfy myself that there was no unreasonable delay in implementing the guidelines. In the event this has been delayed as a result of the significant level of interest shown in the guidelines, and the number and nature of comments and requests for clarification made to my Office. My officials have considered these carefully, and have sought to take all relevant points into account in issuing these revised guidelines.
- xiv I am sending copies of the guidelines to all lenders and brokers in the non-status lending market of which my Office is aware, and to a number of other interested bodies and organisations. Copies are also being sent to all Trading Standards Authorities, which, as enforcement authorities under the Consumer Credit Act, supply me with relevant information about licensees in their areas.
- xv At the same time I am writing to lenders and brokers asking whether and to what extent they are involved in secured lending to non-status borrowers, and whether and to what extent their contract terms and conditions and practices are in accordance with the revised guidelines. I will be monitoring closely compliance with the guidelines, and will not hesitate to take appropriate action where necessary.
- xvi The non-status lending market is novel and fast-evolving. Inevitably my Office may not be aware of every business involved. If any business which is active in this

market does not receive a copy of these guidelines directly from my Office, this in no way absolves them from compliance. I should also welcome information from such businesses about the extent of their involvement and how they are complying with the guidelines².

JOHN S BRIDGEMAN
DIRECTOR GENERAL OF FAIR TRADING

November 1997

² Further copies of these guidelines may be obtained free of charge from OFT Publications, PO Box 172, East Molesey, Surrey KT8 0XW (tel: 0181-957 5058).

**NON-STATUS LENDING
GUIDELINES FOR LENDERS AND BROKERS
Revised November 1997**

Structure of guidelines

- 1 These revised guidelines are sub-divided as follows (the figures in brackets indicate the equivalent paragraph numbers in the July version):

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Scope of guidelines

- 2 The guidelines apply to all lenders and brokers insofar as they are involved in mortgages or other secured loans to **non-status borrowers** - that is to say, individuals with impaired credit ratings or who might otherwise find it difficult to obtain finance on normal terms and conditions from high street banks and building societies and other traditional lending institutions. Such individuals are variously referred to as non-status, non-conforming or sub-prime borrowers. They may be less knowledgeable or experienced in financial matters than the generality of consumers, and on the whole they are more vulnerable.
- 3 There are two broad categories of non-status borrower. The first comprises borrowers with an **impaired** credit rating - for example, because of outstanding county court judgments or arrears. The second comprises borrowers with a **low** credit rating - for example, because of a poor history of employment or because their income through self-employment is irregular or difficult to verify - or who lack the supporting documentation necessary to obtain a loan from a high street lender.

- 4 If a borrower has an impaired or low credit rating, and so would find it difficult generally to obtain finance from traditional sources on normal terms and conditions, then they will be ‘non-status’ regardless of the identity of the lender with whom they deal. The fact that a high street bank or building society may in the event offer the borrower a loan on its usual terms and conditions does not take that borrower out of the non-status category nor absolve the lender from having proper regard for these guidelines where applicable so far as that borrower is concerned. The question lenders need to ask themselves is whether a borrower’s credit rating is such that most other lenders would either refuse the borrower a loan or would offer a loan only on different terms and conditions - for example, a higher interest rate - from those applying to the generality of borrowers.
- 5 The guidelines are directed principally at unregulated lending (where the amount of credit is above the current limit for regulated agreements), since that is where the Office has identified the greatest problems, although they also apply to regulated lending insofar as the statutory regime does not apply. They apply only to secured loans for non-commercial purposes.

General principles

- 6 There are a number of general principles underlying these guidelines, of which the following are the most important:
- there should be transparency in all dealings with potential and actual borrowers, with full and early disclosure and explanation of all contract terms and conditions and all fees and charges payable
 - there should be no high-pressure selling, and adequate time should be allowed for the borrower to reflect on the terms and conditions of the loan and to obtain independent advice before signing
 - advertising and other promotional material should not mislead, and there should be no cold-calling or canvassing off trade premises without the borrower’s prior consent
 - brokers should disclose at the outset their status with regard to the borrower and the lender, and the extent of the service offered to the borrower, together with any brokerage fee or commission payable by the borrower or the lender
 - lenders should take all reasonable steps to ensure that brokers and other intermediaries regularly marketing their products do not engage in unfair business practices, or act unlawfully, and that they serve the best interests of the borrower

- contract terms and conditions should be fair, and should be written in plain English to ensure as far as possible that borrowers understand the nature of the loan agreement and their rights and responsibilities under it
- there should be responsible lending, with all underwriting decisions subject to a proper assessment of the borrower's ability to repay and taking full account of all relevant circumstances
- any ancillary charges (for example, on default or early settlement) should be brought to the attention of the borrower before the agreement is entered into and should reflect as closely as possible the costs reasonably incurred by the lender and not already recovered at the time when the charges are made.

Advertising and marketing

- 7 Advertisements and other promotional material should be clear and easily legible, and should not mislead. While advertisers may indicate that they can respond quickly, the advertisements should not place undue emphasis on this. They should not suggest, either expressly or by implication, that loans are available regardless of the income or other financial circumstances of the borrower, and dependent only upon the value of equity in the property on which the loan is to be secured. They should make clear that all lending is subject to a proper assessment of the borrower's ability to repay.
- 8 Advertisements and other promotional material should comply in all respects with the Consumer Credit (Advertisements) Regulations. They should include a prominent warning statement that the borrower's home is at risk if they do not keep up repayments on a mortgage or other loan secured on it. The advertisement should indicate the name of the lender or broker who has placed it, together with the name of any parent company also active in this market. If the broker is tied to a particular lender in respect of the business being advertised, this should be made clear, and the name of the lender should be clearly stated. Any interest rates shown should be accurate and representative of the business being advertised. If an interest rate other than the APR is shown, greater prominence should be given to the equivalent APR. If an interest rate is shown which is not generally applicable, but may vary according to the status of the borrower or for other reasons, this should be made clear.
- 9 There should be no cold-calling by telephone or home visits. Brokers and other intermediaries, and direct salespersons, should not visit the borrower's home except at the borrower's specific invitation, preferably in writing, and only if the purpose of the visit is made clear in advance. Any such visit should be at a time convenient to the borrower, and the broker or salesperson should not overstay their welcome or remain late into the evening. The borrower should be allowed sufficient time to consider the agreement and to obtain independent advice. Firms should avoid engaging in credit

advertising by telephone to consumers who are known or likely to be non-status if the credit being advertised would be secured on the borrower's home.

Transparency - lender to borrower

- 10 The contract documentation should set out clearly the borrower's rights and responsibilities under the agreement. Contract terms should be written in plain and intelligible language, and be easily legible. They should not be unfair within the meaning of the Unfair Terms in Consumer Contracts Regulations, taking into account the purpose and nature of the agreement and the circumstances giving rise to it and the relative bargaining strengths of the parties. All other documentation should similarly be written in a clear and easily comprehensible manner, avoiding use of legal and technical language. The name and address of the lender, together with the name of any parent company also active in the market, should be shown prominently in all contract documentation and correspondence.
- 11 Lenders might consider issuing a customer booklet, or similar document, for retention by the borrower, setting out clearly the principal terms and conditions and implications of the loan agreement. Any such document should be kept reasonably brief and to the point, avoiding any unnecessary material, and using plain English throughout. It should warn that the borrower's home is at risk if they do not keep up repayments.
- 12 The borrower should be encouraged to read all contract documentation carefully, and to obtain independent legal or other advice (for example, from a Citizens Advice Bureau or Money Advice Centre or Law Centre) before entering into the agreement.
- 13 The contract documentation should indicate clearly the APR, the amount of the initial repayment, and the number and frequency of subsequent payments. Inclusion of an annual flat rate of interest should be avoided, as this may be misleading to borrowers. If an interest rate other than the APR is shown, this should be of no greater prominence than the APR. If interest rates can be varied unilaterally by the lender, this should be made clear, and the manner in which and the basis upon which rates may vary should be explained. It would be helpful to borrowers to illustrate, by way of example, in the contract documentation or an accompanying leaflet, how the monthly payment would be affected by a change in interest rate of one percentage point. The contract documentation should explain clearly when and how payments will be due, and the consequences of failure to make payment on time.
- 14 If the loan is conditional on payment protection or other insurance, this should be made clear to the borrower at the outset. The contract documentation and any customer booklet or leaflet should set out clearly the purpose and nature of the insurance, and the contract documentation should also set out the terms of the

insurance and its cost. The insurance should be appropriate to the borrower's needs and circumstances, and should not give rise to unnecessary expense for the borrower. It will not always be in the best interests of the borrower for the insurance premium to be payable in a single lump sum, which is added to the loan. The borrower should generally be free to obtain the insurance from any source, subject only to the borrower providing the lender with satisfactory evidence of the insurance and its coverage.

- 15 Any customer booklet or leaflet should warn that the broker or other intermediary may not be in a position to give unbiased advice if they are tied to the lender or are paid a fee or commission by the lender. It should encourage the borrower to notify the lender if the broker engages in unacceptable practices or misleads the borrower in any way. It should indicate that the broker may charge the borrower a brokerage fee, as part of the agreement between them. It should make clear that any such fee is not a condition of the loan, but that the borrower may choose to pay the fee out of the proceeds of the loan, in which case the lender will (at the borrower's request) disburse the fee to the broker.
- 16 The contract documentation and any customer booklet or leaflet should set out clearly any other fees or charges payable by the borrower. They should explain the purpose and nature of the fee, the basis of calculation, the amount due, when and how payable, and to whom. They should also indicate if any commission or other payment is payable by the lender to the broker, and should explain the purpose and nature of any such commission and the basis of calculation.

Transparency - broker to borrower

- 17 Brokers and other intermediaries should make clear to the borrower at the outset their status with regard to the borrower and the lender, and the extent of the service they are offering. They should disclose if they are tied in any way to a particular lender, the nature and extent of any such tie (including any right of first refusal), and the implications of this for the broker's role with regard to the borrower. This is regardless of whether there is any formal agreement between the lender and the broker. If there is provision for the broker to receive 'volume overrides' or other commission from the lender in respect of the total volume or value of business brought to the lender over a given period, or for the lender to provide financial or other support to the broker in return for the broker promoting the lender's products, this is liable to accentuate a conflict of interest on the part of the broker, and should be disclosed to the borrower.
- 18 Brokers should give advice to borrowers which is suitable and appropriate to the needs and circumstances of the borrower. Where the broker is unwilling or unable, for any reason, to consider all relevant product types and sources available on the market, and to offer the product which best suits the particular needs and

circumstances of the borrower, this should be made clear to the borrower. The broker should act in the best interests of the borrower, and in accordance with the duty of reasonable care implicit in the relationship between them. Any advice should be clear and accurate, and should not mislead, and should preferably be confirmed in writing.

- 19 Brokers should disclose, both orally and in writing at the outset, the existence of any brokerage or other fees payable by the borrower. They should explain clearly the purpose and nature of the fee, when and how payable, and to whom. They should indicate the basis on which the fee will be calculated, and the amount due if known. If the amount of the fee is not fixed at the outset, either in absolute terms or as a percentage of the loan, the broker should indicate the factors which will determine its calculation, together with the likely amount of the fee. The borrower should have as good an idea as possible of the likely liability. The borrower should be notified in writing of the actual amount of any fee before entering into the loan agreement, and preferably before the loan application is submitted to the lender.
- 20 Brokers should disclose, both orally and in writing at an early stage, the existence and nature of any commission or other payment payable by the lender, and of any other reward available from the lender. They should explain clearly the implications of any such commission for the broker's role with regard to the borrower. This is in order that the borrower is clear as to any potential conflict of interest on the part of the broker. The Office would encourage brokers to 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. Where this is not done, the broker should disclose the factors which will determine its calculation, including whether it will be a percentage of the loan or a fixed sum, and whether it is intended to reflect the actual costs incurred by the broker in arranging the loan or is linked to the total volume or value of business brought to the lender over a given period. All such disclosures should be made in writing before the borrower enters into the loan agreement, and preferably before the loan application is submitted to the lender. There should also be appropriate disclosure in writing of any non-cash benefits provided by the lender, or available to the broker, quantified where possible in cash terms per loan.
- 21 Brokers should comply with the provisions of section 155 of the Consumer Credit Act, regarding the right to recover brokerage fees if the consumer does not enter into a relevant agreement within six months of an introduction to a prospective source of credit. These provisions apply to all intermediaries acting as credit-brokers within the meaning of section 145 of the Act, regardless of whether they describe themselves as brokers or in some other way. They should not seek to evade the provisions of section 155 by including in the brokerage agreement a term purporting to contract out of those provisions, or by seeking to disguise any part of the fee or commission by giving it some other name or by transferring payment to a connected third party. Fees paid to a

third party may be recoverable by the consumer if the third party is not genuinely at arm's length from the broker and if the fees were in reality part of the fee or commission for the service of credit brokerage. All fees repayable under section 155 should be returned promptly.

- 22 Brokers should not purport to offer general advice to local authority tenants on 'right to buy' schemes, or to be acting on behalf of a local authority, when this is not the case. Any brokerage or other fees should not be misrepresented as being for the purpose of home improvement, when that is not the case, in order to satisfy the requirements of local authorities under such schemes.

Selling methods

- 23 Brokers and other intermediaries, and direct salespersons, should not use high-pressure selling techniques or engage in the aggressive promotion of loans. They should not seek to pressurise the borrower into entering into a loan without adequate time to reflect. There should be no financial or other inducements for the borrower to sign within less than seven days.
- 24 Copies of the contract documentation and any customer booklet or leaflets should be provided to the borrower at an early stage. The borrower should be allowed adequate time to read the documents and to consider the terms and conditions of the loan before signing the loan application and agreement. Brokers and salespersons should explain clearly to the borrower what the documents are and what they mean. They should make all reasonable efforts to ensure that the borrower genuinely and fully understands the nature and terms of the agreement and their obligations under it. They should not mislead the borrower in any way, nor misrepresent as to the form, nature, purpose or implications of the loan.
- 25 Brokers and salespersons should explain clearly to the borrower the consequences of failure to abide by the terms of the agreement, or to keep up repayments, and what will happen if the borrower wishes to redeem the loan early. They should encourage the borrower to obtain independent legal or other advice before signing the agreement, and should allow sufficient opportunity for this. They should not discourage the borrower from seeking impartial advice or from shopping around.
- 26 Brokers and salespersons should make all reasonable efforts to satisfy themselves as to the borrower's ability to meet the repayments due under the agreement. They should not distort the borrower's income, or incite or acquiesce with the borrower to falsify details of income or employment or other information. They should not encourage the borrower to take out a loan which is higher than the borrower originally requested, or than the borrower genuinely wants or needs, or which is beyond the borrower's ability to repay.

- 27 Brokers and salespersons should not encourage the borrower to take out a loan for an amount above the current limit for regulated agreements in order to avoid the provisions of the Consumer Credit Act. They should not encourage the borrower to replace unsecured debt with secured debt, or to consolidate other debts in order that the lender may obtain a first legal charge over the property, unless this is clearly in the best interests of the borrower and is explained fully to the borrower. They should warn that the borrower's home is at risk if they do not keep up repayments on a mortgage or other loan secured on it.
- 28 Brokers and salespersons should ensure that the loan application is completed correctly, and in full, and to the best of their knowledge is true and accurate. They should not encourage or allow the borrower to sign blank forms or photocopies, or anything that has not been properly filled in, and they should seek to ensure that the borrower gives proper consideration to the matters in question. They should not fill in any part of the loan application intended to be completed by the borrower except with the express consent of the borrower and on the basis of information provided by the borrower or with their approval.
- 29 Brokers and salespersons should not encourage the borrower to enter into an agreement for temporary finance, such as a bridging loan (which can be expensive), where this is unnecessary or does not meet the borrower's requirements. They should not encourage the borrower to take out payment protection or other insurance products, if not a condition of the loan, unless this is clearly in the borrower's best interests and is explained fully to the borrower. The purpose and nature of the insurance, and the terms of the insurance and its cost or likely cost, should be made clear to the borrower at an early stage, and where possible a sample policy should be provided. The broker or salesperson should have particular regard when advising the borrower to any restrictions or exclusions in the insurance policy.
- 30 Brokers and salespersons should not place a priority search at the Land Registry except with the prior consent of the lender, and only if the lender has received full application details and intends to lend to the borrower. The priority should not be used as a means of preventing or inhibiting the borrower from obtaining a loan from another source. It should be removed promptly, and without charge, on the borrower's request.

Brokers and lenders

- 31 The actions of brokers and other intermediaries involved in marketing a lender's products can jeopardise the lender's fitness to hold a consumer credit licence, as well as that of the broker. Section 25(2) of the Consumer Credit Act makes clear that the fitness of a licensee can be brought into question by the actions of any of its employees, agents or associates (whether past or present), and section 25(3) defines

‘associate’ for these purposes as including a business associate. A broker may be a business associate of a lender if the broker is tied to the lender (for example, through a right of first refusal agreement), or has an ongoing relationship with the lender, or frequently does business with the lender. This is a matter of fact and degree. It is not necessary for the purposes of determining that an association exists that any formal agency relationship should exist between the lender and the broker.

- 32 Lenders should take all reasonable steps within their control to ensure that brokers and other intermediaries marketing their products comply with all relevant statutory requirements, and with these guidelines, and do not engage in business practices which are deceitful or oppressive or otherwise unfair or improper (whether unlawful or not). This applies particularly where the broker may be regarded as a business associate of the lender.
- 33 If a lender accepts business from a broker or other intermediary on a frequent basis, in return for payment of a fee or commission, the lender should take steps to satisfy itself that the business is being procured in an acceptable manner and that the broker’s procedures are in compliance with the law and with these guidelines. The lender should investigate thoroughly any allegation or evidence of malpractice on the part of the broker. If a lender chooses to do business with a broker which it has reason to know or believe engages in business practices which are deceitful or oppressive or otherwise unfair or improper, to the detriment of consumers, its choice may be considered a circumstance relevant to fitness even if the lender has no formal control over the broker and no informal means of influencing the broker.
- 34 The Office would encourage lenders to bring to its attention any evidence of brokers or other intermediaries who engage in unfair business practices or act unlawfully.
- 35 Lenders should consider putting in place procedures for asking borrowers direct as to how the broker has conducted business with them, and whether the borrower is satisfied with the service provided. Where the broker has filled in any part of the loan application on behalf of the borrower, the borrower might be asked to confirm that the details have been entered correctly, and in full, and correspond with the information provided by the borrower.
- 36 Lenders should ensure that their commission structure does not encourage brokers to offer any particular product from the lender over any other product from that lender. If the rates of commission payable by the lender vary between products, or according to the status of the borrower or for other reasons, this should be made clear to the borrower. Any such difference 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 lender. The broker should not be able to influence the rate of commission payable, for example by securing a larger loan or higher interest rate from

the borrower. The Office would discourage the use of ‘volume overrides’, 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 lender over a given period, but where such volume overrides exist they should be clearly disclosed to the borrower by the lender and the broker. Any other payments or non-cash benefits should be provided in such a way as not to encourage undue lender or product bias on the part of the broker.

- 37 Lenders should not disburse brokerage fees on behalf of the borrower without the latter’s prior written request, confirming that the fact and amount (or likely amount) of the fee were disclosed by the broker before the loan application was forwarded to the lender, and that the fee is to be paid from the amount advanced.

Underwriting

- 38 Lenders should comply at all times with the principle of responsible lending. All underwriting decisions should be subject to a proper assessment of the borrower’s ability to repay, taking full account of all relevant circumstances including the purpose of the loan, the borrower’s income, outgoings, employment, age, state of health and previous credit history, and details of any other mortgages or loans or any life assurance cover or payment protection insurance. The aim should be to ensure that the borrower does not take on a commitment which they are unlikely to be able to fulfil. If brokerage or other fees, or an insurance premium, are to be added to the loan, the lender should assess the borrower’s ability to repay on the basis of the total amount of the loan including any such charges.
- 39 Lenders should take account of any seasonal variations in the borrower’s income, and any likely future changes in income or employment or other relevant circumstances, together with the nature and extent of any existing financial difficulties. They should concentrate on the borrower’s ability to repay the loan, rather than on the value of equity in the property on which the loan is to be secured.
- 40 Lenders should take all reasonable steps to verify the accuracy of information provided on or in support of the loan application. They should check any apparent omissions or discrepancies, and query any unusual features. They should ensure that all underwriting staff are properly trained and supervised.
- 41 In assessing ability to repay, lenders should ensure that they have sufficient evidence regarding the borrower’s income and other financial details. What will be sufficient in any given case will depend upon the circumstances of that case, and is a question of fact and degree. The need for supporting evidence will be greater, the higher the self-declared income or the larger the loan relative to the borrower’s income or other financial circumstances. If adequate documentary evidence is not available, and 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. It might also be regarded as lending on equity alone. Both of these the Office has long regarded as unacceptable.

Contract terms

- 42 The borrower should be free to withdraw from the agreement, without penalty, at any time prior to completion of the loan. This should be set out clearly in the contract documentation and in any customer booklet or leaflet. Lenders might also consider allowing the borrower a right to cancel the agreement if the borrower notifies the lender within a set period following notification of completion of the loan, although the Office recognises that this may not always be practicable, particularly where the loan is to finance a house purchase.
- 43 The agreement should not entitle the lender to change unilaterally, at short notice, the date on which monthly repayments are due. Any change in payment date should be made only with the consent of the borrower, or subject to prior written notice of at least two months. The borrower should have a contractual right to request a change of payment date, such a request not unreasonably to be refused by the lender. This might be useful, for example, if the date for receipt of regular income by the borrower changes. Any financial implications for the borrower of a change of payment date should be made clear in advance.
- 44 Lenders should give prompt written notice of any change in contract terms and conditions. If there are significant changes in any one year, the lender should send a copy of the new terms and conditions, or a summary of the changes, to the borrower on the anniversary of the loan. Lenders should give written notice of any increase in interest rates at least 14 days prior to the date on which the relevant payment falls due. They should provide promptly to the borrower, either routinely or on request, an annual statement of account, showing clearly the amounts paid and unpaid during the year, any interest or other charges, and the current amount of any arrears.
- 45 The agreement should allow the borrower to make partial repayments of capital at any time in order to reduce the level of future repayments. Any charge for this should do no more than cover the costs reasonably incurred by the lender in processing the payments.
- 46 If the borrower goes into arrears, lenders should deal with this sympathetically and positively. They should monitor the accrual of default charges carefully, to prevent the arrears building up too quickly or excessively. They should notify the borrower, in writing, each month while the borrower is in arrears, of the current amount of the

arrears, together with the amounts paid and unpaid since the last notification and any interest or other charges including default charges.

- 47 Lenders should not seek to repossess the borrower's property except as a last resort. They should explore all other possible options for dealing with the problem, and should give proper consideration to any reasonable offer by the borrower to pay by instalments. They should not insist unreasonably that the arrears are paid in one payment or in large amounts. They should not institute court proceedings unless and until all other avenues have failed.
- 48 Lenders should not harrass the borrower through excessive or intimidatory telephone calls or correspondence, or through contacting the borrower at unsociable hours. They should not disclose the fact that the borrower is in arrears to any third party without the borrower's consent. They should respond promptly to any telephone calls or correspondence from the borrower or from the borrower's agent or representative.

Dual interest rates

- 49 The July guidelines made clear the Office's view that the dual interest rate schemes operated by a number of non-status lenders - in particular, those involving a large differential between the two rates - were unfair and oppressive and should be discontinued. The move from the concessionary to the standard rate could not generally be justified in terms of the administrative costs incurred by the lender on default, and was likely to accentuate the borrower's financial difficulties and thereby increase the risk of repossession. The Office had received a number of complaints regarding the operation of such schemes in the non-status lending market, including that they were being marketed and sold on the basis of the lower rate; that there was insufficient transparency as to the basis on which and circumstances in which each rate would apply; that borrowers did not understand properly the operation of the dual rate regime or were led to believe that only the lower rate was applicable; and that the borrower's ability to repay the loan was assessed on the basis of the lower rather than the higher rate. Furthermore, the extent of the differential between the rates was such that lenders would benefit financially from the borrower's default rather than merely covering their incurred costs.
- 50 Section 93 of the Consumer Credit Act provides that, for regulated consumer credit agreements, the rate of interest must not be increased on default.
- 51 Dual interest rate schemes may in some cases involve a penalty on default, and so be unenforceable through the courts by virtue of the common law rule on penalties. This will be the case if the loan agreement provides for an ordinary rate of interest together with a higher rate payable on default, and if the sum payable on default exceeds a genuine pre-estimate of the lender's loss arising from the breach of the borrower's

contractual duty owed to the lender. Relevant factors would be the extent of the differential between the ordinary rate of interest and the default rate, and whether the default rate was payable retrospectively as well as prospectively.

- 52 The contract terms of dual interest rate schemes are also liable to challenge under the Unfair Terms in Consumer Contracts Regulations (from 1 July 1995). In the Office's view, a term providing for a higher rate of interest on default cannot be a core term within Regulation 3(2), regardless of how the term is drafted and whether the higher rate of interest is expressed to be the ordinary rate. The term providing for the higher rate of interest is in substance a term making provision for payment of compensation upon a breach of an obligation and not, therefore, a core term.
- 53 A term to which the Regulations apply shall not be binding on the consumer if it is unfair. The test for unfairness is set out in Regulation 4 and Schedule 2 to the Regulations, and Schedule 3 sets out an indicative and non-exhaustive list of terms which may be regarded as unfair. These include terms which have "the object or effect of ... requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation".
- 54 Regulation 6 of the Unfair Terms in Consumer Contracts Regulations provides that any written term of a consumer contract must be expressed in plain, intelligible language. If there is doubt about the meaning of a written term, the interpretation most favourable to the consumer shall prevail. This does not justify the use of ambiguous terms.
- 55 If lenders wish to recoup the administrative costs incurred on default, they should do so by means of direct charges to the borrower. Any such charges should be reasonable, and should do no more than cover the lender's administrative costs incurred on default.
- 56 The contract documentation and any customer booklet or leaflet should set out clearly the reasons for any default charges, the nature of the costs which they are intended to cover, and when and how they may be applied. They should indicate the scale of charges applying at the date of the loan application and contract. Any subsequent alteration in the charges should be notified in writing to the borrower, who should also be sent details of the prevailing scale of charges if and when they go into default and at intervals of not more than three months while in arrears.

Early redemption

- 57 The July guidelines made clear the Office's view that use of the Rule of 78 in the non-status lending market can be unfair and oppressive as it tends to produce a settlement figure which is excessive relative to the amount borrowed and repayments made and

relative to the costs incurred by the lender. Lenders should discontinue its use at the earliest opportunity, and should not apply it rigidly to existing loan agreements without some form of cap to ensure that payments on early redemption are not excessive.

- 58 The above conclusions apply solely in relation to unregulated non-status loans, as the position for regulated loans is governed by the Rebate Regulations made under section 95 of the Consumer Credit Act. The Director General has written recently to DTI Ministers, urging a review of those Regulations. Consideration should be given in any such review to the Office's recommendations in its report on *Consumer Credit Deregulation* in June 1994, and to subsequent comments on that report. Further announcements may be made in due course regarding the wider use of the Rule of 78 in all types of credit agreement.
- 59 Use of the Rule of 78 in unregulated loans is liable to challenge under the Unfair Terms in Consumer Contracts Regulations (from 1 July 1995). As indicated above, Schedule 3 to those Regulations includes, as an example of terms which may be regarded as unfair, terms which have "the object or effect of ... requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation". In the Office's view, the application of the Rule of 78 in mortgage transactions can result in a rebate to the borrower which is disproportionately low, and so the borrower may end up paying a disproportionately high sum to redeem the mortgage. A term to which the Regulations apply shall not be binding on the consumer if it is unfair.
- 60 In addition, Regulation 6 of the Unfair Terms in Consumer Contracts Regulations provides that a written term of a contract must be expressed in plain, intelligible language. The Office has not encountered any contract term which describes the operation of the Rule of 78 in a way which is likely to enable the consumer to understand it and appreciate its significance.
- 61 Lenders should cease using the Rule of 78 in relation to unregulated secured loans to non-status borrowers. They should move to alternative methods of calculating the settlement figure such as the actual reducing balance or actuarial methods. Any charges for early redemption should be reasonable, and should do no more than cover the lender's administrative costs together with any other costs reasonably incurred to date and not already recovered. It may be appropriate for such charges to be expressed by reference to a sliding scale of charges which closely approximates to these costs. Lenders should not seek to use the imposition of charges on the early redemption of a loan as a means of recovering costs which were not reasonably incurred in relation to that loan, or which were clearly excessive and disproportionate to the circumstances of the loan.

- 62 There should be adequate transparency. The contract documentation and any customer booklet or leaflet should set out clearly the method of calculation of the settlement figure and any redemption charges, and should explain the reasons for these together with the nature of the costs which they are intended to cover. They should indicate the settlement figure and redemption charges that would apply, on the basis of current interest rates, at different points in the contract, including after each of the first five years of the loan. These details should also be included prominently in any documentation sent to the borrower before the conclusion of the loan setting out the borrower's right to withdraw from the agreement. The borrower should be fully aware before entering into the agreement of the implications of settling early.
- 63 Lenders should provide promptly to the borrower, on request at any time, a clear written statement of the settlement figure and redemption charges that would apply at any particular point in the contract. They should respond promptly to any reasonable request by the borrower for an explanation of the figures or of the basis on which they have been calculated and derived.

**OFFICE OF FAIR TRADING
CONSUMER AFFAIRS DIVISION**

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