
Response to the super-complaint on home credit made by the National Consumer Council

10 September 2004

OFT747a

BACKGROUND

1 On 14 June 2004 the National Consumer Council (NCC) submitted an informal super-complaint to the Office of Fair Trading (OFT) about home credit (HC). In its super-complaint, the NCC stated that it does not believe that the HC market is working well. The NCC highlighted the following features about which it had concerns:

- little evidence of switching by HC customers, either to different HC suppliers or to other products and providers
- significant switching costs for HC customers if they wish to change HC supplier
- information asymmetries which make it difficult for HC consumers accurately to assess the costs of HC or compare them with other types of credit
- high market concentration which may reduce consumer choice and limit the extent of competition
- barriers to entry which reduce the likelihood of new lenders joining the market
- high prices.

- 2 The right to submit super-complaints was created by section 11 of the Enterprise Act 2002 ('the Act'). A super-complaint is defined under section 11(1) of the Act as a complaint submitted by a designated consumer body that 'any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers'. The NCC's application for designated consumer body status was being considered by the Secretary of State for Trade and Industry at the time the super-complaint was submitted. We decided to treat the super-complaint as if the NCC had been designated at the time it was submitted, and to respond accordingly. The NCC was designated on 14 July 2004.
- 3 Section 11(2) of the Act requires the OFT, within 90 days of receiving a super-complaint, to publish a reasoned response saying what action, if any, it proposes to take. This document and the attached consultation paper address the key issues raised by the NCC, and represent the OFT's response to the super-complaint.
- 4 In considering this super-complaint we have consulted interested parties, including lenders and their trade association, by means of meetings and a questionnaire. We have also drawn on the knowledge of the HC market which the OFT has gained as a result of its regulatory role under the Consumer Credit Act 1974.

Overview of the sector

- 5 HC consists of the provision of small sum credit, the repayments for which are collected in regular instalments (typically weekly) by agents who call for that purpose at the customer's home. The core HC business is the supply of cash loans. Some HC lenders also use the sale of shopping vouchers, hampers, or other goods on credit, to attract customers for their cash loans. Recent research values the UK market at £2bn.
- 6 HC allows customers to access cash at short notice with a relatively low likelihood of rejection. Regular, affordable repayments are agreed between the customer and the lender's agent, who will call at the customer's home to collect them, making budgeting easier. Together with the knowledge that late or missed payments do not incur a penalty,

this can make HC an attractive source of credit, particularly to customers whose access to other forms of credit may be limited. The demand for the service is demonstrated by the substantial numbers using it: the NCC super-complaint said that around 10 per cent of consumers in Great Britain had used HC at some point in their lives and five per cent had done so in the last twelve months. APRs for HC are, however, high: the NCC gives an average figure of above 177 per cent. HC lenders told us that the price differential for HC may be accounted for by factors such as the default risk, the nature of the product (unsecured, short term loan with flexible payments), agent network costs, and the lenders' cost of capital.

- 7 Around 500 firms are involved in the market, most operating at a local or regional level. Overall, however, the market is concentrated, with four firms accounting for nearly 70 per cent of business.

Regulatory framework

- 8 The market is regulated under the Consumer Credit Act 1974. Key elements are:

- licensing: HC lenders have to be licensed. The OFT can revoke an HC supplier's licence or refuse to issue or renew a licence if it has evidence that the supplier is not a 'fit person' to hold a licence. This may include evidence of unfair or improper business practices;
- a ban on soliciting and canvassing cash loans. It is a criminal offence for a supplier to propose a cash loan to a customer off trade premises without a prior signed written request to visit for this purpose. There is no equivalent ban for canvassing or soliciting the sale of goods supplied on credit – HC lenders can lawfully canvass the sale of shopping vouchers, hampers etc in the customer's home.

- 9 The DTI is in the process of reforming the consumer credit regime; a Consumer Credit (Amendment) Bill is expected in the next session. The likely changes include stronger powers for the OFT to investigate unfair

business practices and a wider range of sanctions. These should strengthen licensing and enforcement capabilities across the credit sector.

ANALYSIS

The market

- 10 The HC market shows high and increasing concentration which is likely to restrict customer choice. The four largest companies have a combined UK market share of outstanding balances of 69 per cent (up from 60 per cent five years ago). The largest company accounts for 49 per cent of the UK market. Over the last decade there has been a gradual decrease in the number of smaller operators in this market, with the largest companies all expanding their business via acquisition. Some small lenders who responded to our questionnaire told us that they were willing to sell their loan books in order gradually to wind down their business and exit from the market, but that the larger companies' interest in purchasing appeared to have decreased. We have been told that the market is flat or declining.
- 11 Personal recommendations and word of mouth play a key role in determining which company customers borrow from, which may limit the ability of new entrants to win customers. In addition, the larger lenders' investment in networks of branches and agents is significant and it would take an entrant time to replicate this. New entrants may also have a higher bad debt risk than existing market players. Such factors may act as a deterrent to entry, particularly entry on a large scale. Regulatory barriers are, however, perceived to be low and entry on a smaller scale is likely to be significantly easier.

Characteristics and conduct of customers

- 12 The evidence we have seen suggests that many HC customers are in a poor bargaining position, due to the perceived high risk that they will default on repayments, the shortage of alternative sources of small sum credit, and their pressing financial need. Furthermore, they do not appear to be price-sensitive when choosing a loan, with factors other than the total amount payable likely to play a significant part in their decision, and

limited evidence that they make price comparisons between lenders. APRs have limitations as a means of comparison both between different HC loans, and between HC and other forms of credit.

- 13 Collectively, these features of HC consumers seem likely to inhibit their propensity to switch between lenders.

Conduct of suppliers

- 14 Coupled with the characteristics and conduct of customers in this market, we have identified aspects of suppliers' conduct which appear to create additional obstacles to switching:

- **the prevalence of step-up loans:** step-up loans, whereby HC suppliers lend small amounts to new customers and make larger amounts available once customers prove themselves reliable with repayments, are standard practice in the HC market. This means that switching to a new HC supplier can require starting with small amounts again unless the new supplier accepts payment books for previous loans as evidence of a customer's repayment history. In a market where creditworthiness is difficult to establish, step-up loans have benefits for both lenders and their customers. They nevertheless increase the propensity for repeat borrowing to be from the current lender.
- **agent/customer relationship:** switching may also be made less likely by the nature of the relationship built up between customers and agents. Agents' remuneration is in many cases linked to their collection performance, which may create a feeling of obligation on the part of the customer. Customers will be aware that agents can allow extra time to make repayments, and may not wish to do anything which might jeopardise a potential source of credit for the future.
- **high levels of refinancing/roll-over of loans by existing lenders:** lenders also make 'roll-over' loans, whereby customers take out further loans with the same lender before fully repaying their current loan. This happens before the loan ends, thus pre-empting the borrower from going elsewhere. To the extent that it is easier

for customers to accept new loans or roll-over existing loans with the same supplier than go elsewhere, and likely that they will do so, this entrenches borrowing from the current lender.

Conclusion

- 15 Overall, the market features we have identified suggest that there may be limited incentive for lenders to compete on price. A number of lenders told us that they do not take into account each others' prices when deciding what they will charge, and that they do not attempt to win business by taking over other lenders' loans. Such a restriction of competition among lenders would be likely to lead to significant harm to the interests of consumers.

PROPOSED ACTION

- 16 The features identified appear to result in a restriction of competition in this market and we believe that the test for a market investigation reference to the Competition Commission (CC) under section 131 of the Act is satisfied. We believe that the CC has broader powers than the OFT to introduce any remedies which it may consider appropriate in the event of an adverse finding following a full investigation. For this reason we do not consider that a market study by the OFT would be a sufficient response to the super-complaint.
- 17 We therefore propose to consult on a market investigation reference to the CC in accordance with section 169 of the Act. The consultation paper attached to this document, which provides more detailed reasons for our proposed action and forms part of our response to the super-complaint, will be sent to those parties on whose interests a reference is likely to have a substantial impact. The OFT Board will decide whether or not to make a reference following the consultation, before the end of the year.
- 18 In the course of investigating the super-complaint, the OFT has received details of a few instances of customer complaints about trading practices. If these appear to merit further investigation by our

enforcement branch, this will be done. Such enforcement action alone, however, would not address the competition issues raised by the super-complaint and would thus not be a sufficient response to it.

- 19 The OFT already plans to carry out an information campaign on credit in November, educating customers about what to look out for when they borrow, and the different options available to them. In preparing this campaign, the OFT will consider whether issues relevant to home credit can be addressed.