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Contextual Questions

Q.1. Political agenda and Affordable Personal Inclusive Credit

The promotion of financial inclusion has been a key national policy objective of the UK Government since the publication of the HM Treasury Policy Action Team 14 report on access to financial services in 1999. At the time, there was a growing concern at local, regional and national level, that exclusion from financial services, principally from access to banking, to affordable credit and to debt advice, was having a negative and damaging effect on the social and economic development of individuals and families, particularly in low-income communities.

In order to ensure that financial inclusion became fully part of the national political agenda, and to oversee and advise on initiatives and actions, the UK Government set up in 2005 the Financial Inclusion Taskforce. This body was representative of the banking, insurance, social and community finance and money advice sectors, as well as of local government, universities and research agencies. Its first priority was to tackle issues around access to banking, to affordable credit and to debt advice. When the work of Taskforce was prolonged in 2008 for a further three years to 2011, it also began to focus on issues related to access to insurance and to the design of savings products for people on lower incomes. During this same period, the Scottish Executive and Welsh Assembly Government also developed their own financial inclusion policies, frameworks and initiatives.

It is hard to be precise about the amount of public investment that has been made into the promotion of financial inclusion up to 2011. In fact, even in 1999, it was estimated that £10–£15 million of public investment was being spent each year on credit union development in order to promote access to saving accounts and to affordable credit in low-income communities (Jones, 1999). Since 1999, the largest single investment has been the UK Government's £250 million Financial Inclusion Fund to further promote access to banking, to affordable credit and to debt advice over the period 2004–11. This would have been enhanced significantly through the considerable additional financial investment of the Scottish Executive, the Welsh Assembly Government, and of local government.

But it has not just been national, regional and local government that has been politically and financially committed to the promotion of financial inclusion. The identification of financial inclusion as an important element of the national policy agenda has resulted in the engagement of large sections of the social housing sector and of the financial services industry, as well as of charitable trusts and foundations. Significant investment into financial inclusion activity has come from all of these major stakeholders. The Tudor Trust, the Northern Rock Foundation and the Friends Provident Foundation have been just a few charitable foundations that have invested significantly in financial inclusion activities, often at a grass-roots level.

A key turning point in the political agenda was the election of the new Coalition Government in 2010 and the ending of the previous administration's financial inclusion strategy in 2011. Undoubtedly, with the commitment to reduce the UK's financial deficit, public sector financial and other resources available for the promotion of financial inclusion have been reduced. A casualty have been the overarching financial inclusion and financial capability strategies developed under the previous administration. However, the Coalition Government appears to remain committed to financial inclusion as a policy objective and has been engaged in endeavouring ways to efficiently fund the debt advice sector, has supported the development of the Money Advice Service in order to offer free financial information and education and has committed £38 million over a three year period to a targeted credit union expansion project to strengthen the organisational capacity of credit unions to deliver access to banking services and affordable credit in low-income communities. This is in addition to the £12 million invested in the credit union and social finance sector in 2011/12 to continue the work of the Financial Inclusion Fund in enabling access to affordable credit.

It is important to note that the financial inclusion of the national population underpins many other key policy objectives of the Coalition Government. Impending welfare benefit reforms and the introduction of Universal Credit[1] will heighten the need for welfare benefit claimants to be financially included and for a series of new financial products to help them budget and manage their money. A significant need has been identified by the Government, for example, for budgeting bank accounts, often referred to as 'Jam-jar accounts', to help people manage the monthly payment of benefits. This monthly payment, for social housing tenants, will include a payment of housing benefit which previously had been paid directly to the social housing provider but which now will have to be managed by the tenants themselves.

Financial inclusion also, for example, underpins the Coalition Government's approach to penal reform, where initiatives to resettle people coming out of prison in the community (see Jones 2009, Bath and Jones 2012).

Welfare reform has also increased the importance of financial inclusion as a policy objective for local authorities, social housing providers, money advice agencies and other agencies, charities and organisations working in low-income communities.

Since the promotion of financial inclusion was identified as a key policy objective in 1999, significant progress has been made in enabling and widening access to financial services for people previously marginalised from the financial system.

Important developments over the past decade include:

- The creation of a basic bank account, a no-frills account designed to offer a basic transaction service (but without cheque book or overdraft facilities). The introduction of this account has halved the numbers of the unbanked since 2006. Of the 2.7 million individuals originally found to be unbanked, 1.1 million have been moved into banking (Financial Inclusion Taskforce 2010a). Research has identified however that usage problems has resulted in about a quarter of all people moved in banking

[1] Cf. http://www.dwp.gov.uk/policy/welfare-reform/

having been economically disadvantaged through behavioural charges on accounts (see Ellison et al. 2010.)

- The introduction of the credit union current account. About 25 credit unions now offer a current account, the equivalent of the banks' basic bank account. However, credit unions have endeavoured to design and manage the current account with their members in mind, offering reduced penalty charges on failed direct debits.(n

- The widening of access to affordable credit through the DWP Growth Fund, which was a constituent element of the Government's Financial Inclusion Fund. The DWP Growth Fund offered revenue support and capital investment to credit unions and community development finance institutions for on-lending in low-income and deprived communities. This resulted in a considerable expansion of the availability of lower-cost credit to financially excluded people. For the period from July 2006 to March 2011, 405,134 Growth Fund loans were made to a total value of £175,351,444. Around 100 community-based credit unions participated in the Growth Fund through which around 85 per cent of all Growth Fund loans were delivered. The remainder was made through community development finance institutions and other agencies. The average Growth Fund loan was around £400.

  The Growth Fund prompted participating credit unions to introduce instant loan products without the traditional requirement to save for a period of 12 weeks before becoming eligible to apply for a loan. This change in practice opened up credit unions to many people who had found it difficult to save before applying for a loan.

- The expansion of free, face-to-face debt advice services in low-income communities. From 2004 – 2011, an investment of £130m through the Financial Inclusion Fund[2] resulted in the employment of around 500 new specialist debt advisors in low-income communities. The Financial Inclusion Fund has been replaced from 2011 with the Face-t- Face Debt Advice Programme. Future funding of the debt advices sector is still under review.

- The expansion of insurance with rent schemes for social housing tenants. Social housing tenants, over 70 per cent of whom receive welfare benefits, are most likely to be subject to burglary but are least likely to have home contents insurance.

- The development of the national Illegal Money Lending Teams. These teams were established to combat illegal lending and to support its victims, many of whom suffer intimidation and violence. There has been considerable success in prosecuting illegal lenders and ensuring criminal convictions.

- The promotion of the importance of saving in the promotion of financial inclusion. Significant work was undertaken into the role of saving in low-income households and national schemes to assist people to save were developed. However the Saving Gateway and the Child Trust Fund were abandoned by the Government due to budget cuts. The Child Trust Fund continues for children born between 2002 and

[2] http://webarchive.nationalarchives.gov.uk/+/http:/www.berr.gov.uk/whatwedo/consumers/consumer-finance/over-indebtedness/debt-advice/index.html

2011. However, the inclusion of saving as a key constituent element of financial inclusion has become a significant element of the national agenda and research undertaken during the period has demonstrated that people on low incomes can save with the assistance of an appropriate savings mechanism (Kempson et al. 2005; Harvey et al. 2007). This is something that has been known in the international credit union movement for a long time (Klaehn and Jimenez L, 2005). Many British credit unions have introduced, for example, various forms of locked-in savings accounts (cf. Christmas savings accounts) to assist people to save.

Alongside these developments, the national policy agenda on financial inclusion has also resulted in a significant body of academic research into the reality and the dynamics of financial exclusion in the UK. This body of research has focused primarily on access to banking, affordable credit, debt and money advice and savings accounts. There has been less work undertaken into access to insurance products (cf. the research work of the Personal Finance Research Centre at Bristol University, Policis, the Financial Inclusion Centre in London, the Centre on Household Assets and Savings Management at Birmingham University, the Centre for Responsible Credit, and also the Research Unit for Financial Inclusion at Liverpool JMU, to name but a few research institutions in the field)

It is also fair to say that academic research, as well as the policy agenda in the UK, has tended to focus on financial inclusion rather than on financial exclusion. This change in emphasis has tended to proactively prioritise the actions and initiatives that can assist people to overcome the difficulties of accessing or using financial services and products in the mainstream market and that can assist financial providers to develop such products and services appropriate to the needs of people who have or who are facing financial exclusion.

Alongside the financial inclusion political agenda, it is also important to note the existence of the distinct but related political agenda in regard to financial education and financial capability. The previous Government had developed a long term approach to financial capability (HMT 2007) and planned for children and young people to have access to a programme of personal finance education in school and for all adults to have access to high quality generic financial advice.

The latter led to the creation of the Money Guidance Service and then to the establishment of the Money Advice Service which was retained and developed by the current government. The previous government did not achieve personal financial education in schools. However, with the publication of the new schools curriculum in February 2013, personal finance education is finally to be taught in all schools as part of mathematics and of citizenship education classes.

Financial inclusion and financial capability education are clearly distinct disciples. However, they do inter-react. It is hard to see how an individual could progress in financial inclusion without a parallel development in knowledge of financial products and services.

Q.1.1. The problem of financial exclusion in the UK

Despite significant advances in the promotion of financial inclusion in the UK, financial exclusion remains a reality for a significant numbers of people on low incomes. Over a million people are still excluded from the banking system, even though this may be often self-exclusion and the result of over-indebtedness than exclusion by the banking industry. There are groups, however that find access to the banking system to be particularly difficult. These include asylum seekers, ex-offenders and the homeless.

In addition, there are still millions of people who have little option but to use high-cost credit facilities. There are few savings facilities for people on low incomes and still most people on a low income do not have home contents insurance. Access to debt advice has improved over recent years but increasingly local debt advice services are under threat due to budget cuts. This is currently a major problem in low-income communities.

Q.1.2. Key aspects of financial exclusion

Access to banking

There has been significant progress in accessing people to a bank account over the last decade. Of the 2.7 million originally found to be unbanked, 1.1 million had been moved into banking by 2010 (FITF 2010 Ellison et al. 2010).

It is now estimated that 0.89 million people in 0.69 million households do not have access to a bank account of any kind; and 1.75 million people in 1.28 million households do not have access to a transactional bank account that allows them to make and receive payments (FITF 2010, Ellison et al. 2010).

The unbanked are mostly concentrated among people in the bottom four income deciles, with 51 per cent in the bottom two, and mainly include single people, lone parents, people who are unemployed and retired, people unable to work through disability and people from some minority ethnic groups (Bangladeshi and Pakistani people in particular) and social housing tenants (FITF 2010). For some vulnerable groups, financial inclusion is a particular problem which compounds their social exclusion. These groups include ex-prisoners and people who have been homeless (Jones 2008).

However, it is important to note that access to banking can bring costs and pitfalls as well as benefits for lower income account holders. A significant number of people who have moved into banking have benefitted from savings on receipts and payments and from the knowledge, security and esteem that they are participating as social and economic citizens in society. However, experience has been mixed for others with a significant number experiencing high penalty charges on their use of accounts. Even though a large majority (70 per cent) feel that they have gained from moving into banking, only a little over a quarter (27 per cent) of the newly banked has gained financially from the move. For a little over a third the move has made little difference whilst 26 per cent have been net losers in economic terms (Ellison et al. 2010).

An important finding by Ellison et al (2010) was that the majority of both the newly banked and those remaining unbanked are not new to the banking system. More than half of the

newly banked and almost two thirds of the remaining unbanked have previously been banked but have fallen out of banking due to penalty charges on accounts. In other words, for many the issue is not access to a bank account, but the money management and financial capability skills that are required to ensure that it is used effectively.

Fear of bank penalty charges has kept many banked people from using their account as a transaction account. Rather it is used a conduit for cash payments and, once a deposit of wages or benefits is made, the money is withdrawn and people then manage as before in cash. Ellison et al. (2010) found that 43 per cent of the newly banked, rising to 53 per cent of those on the lowest incomes, continue to manage entirely in cash. They found that resistance to electronic payment channels is primarily driven by fear of penalty charges but also by a preference for the flexibility afforded by cash payment channels. Even though the cost is higher, for example, people some prefer to pay electricity and gas bills with a card meter rather than risk payment by direct debits. In order to keep control over the household budget, other bills would be paid either at a post office or a Pay Point[3] outlet (Hamlyn 2006) rather than through the use of the bank account.

An important research finding is that few of those who had never been banked, had applied for an account and been turned down (Ellison et al. 2010). For the most part, even though there are important exceptions (cf. people in and leaving prison or who have been homeless, Jones 2008), people who want a basic bank account are able to obtain one. The reasons for remaining outside the banking system differ between those who have been previously banked and those who have never been banked. The former, mostly who left banking because of over-indebtedness through penalty charges, are deterred by a fear of bank charges and loss of control over their finances, whereas those who have never banked often consider that they have no need for an account and prefer to manage in cash. Kempson and Collard (2012) argue that the existence of the Post Office Card Account has acted as a barrier to encouraging further banking inclusion (Kempson and Collard 2012). This card offers people the opportunity to receive benefits through a post office. It cannot be used for the receipt of wages or any other deposit and has no banking functionality. However, for someone who prefers to manage in cash it is often an adequate conduit for benefits.

It is to be noted that access to banking has been mostly driven by third party requirements, for the payment of wages, benefits or pensions, or even by the fact that some services, such as satellite and cable television, are only supplied if payments are made by direct debit from a bank account (Ellison et al.2010). As has already been noted this can have advantages, but has had some serious financial disadvantages for about a quarter of the people accessed into banking.

It also should be noted that about 25 credit unions now offer a current account which has similar features to a basic bank account. However, most credit unions credit unions charge a monthly fee of around £5 for this but in return, make no additional charge for failed direct debits or going into overdraft apart from the charge levied on the credit union by its host

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[3] PayPoint is an electronic card payment service that operates through local retail outlets, with its costs of operation covered by the company being paid.

bank (The Co-operative Bank). The flexible, member-friendly approach of credit unions to transaction banking was confirmed in a 2008 research study (Jones 2008), where members with credit union current accounts were largely happy to pay a monthly charge in exchange for lesser penalty charges and a more approachable and less risky service.

Access to affordable credit

The UK has one of the most diverse and extensive credit markets in Europe. Credit is not only offered by banks and mainstream financial providers, but by a large sub-prime alternative and high-cost sector of money shops, payday lenders, home credit providers, pawn shops, sale and buyback stores, weekly pay rent-to-own stores and others. There is also a small but growing social finance sector that aims to offer an alternative to high-cost providers.

Certainly access to credit has become more difficult for all since the financial crisis, but it is still available to many people, but not all, on low-incomes but at a cost. In the UK, the financial inclusion issue is not so much access to credit, per se, but access to affordable credit. By affordable credit is meant credit at a fair and reasonable rate of interest which will not impact negatively on the household budget in the medium to long term.

Of course for many, the definition of fair and reasonable is contested, as is the notion of a negative impact on the household budget. For many borrowers, particularly on a low income, the cost of credit is not the issue, access is. This can lead to sub-prime lenders offering credit, which on a weekly pay-basis, appears reasonable but long-term has a significant negative impact on a household's financial disposable income.

However, in the UK credit use is part and parcel of the harsh reality of the life of people living on a low income. For many people, who lack the safety net of savings, it is the only way to balance the ups and downs of household income and expenditure and to fund major purchases and essential items. But its benefits are also weighed against its dangers. Credit use adds to the stress on household budgets, reduces disposable income and increases the risk of financial distress and breakdown.

Recent research has shown that almost seven in ten (69 per cent) low-income households, 10.55 million individuals, are credit users. Of these, 10 million (66 per cent) use commercial credit and only 0.5 million (3 per cent) use social credit (Ellison et al 2011). A substantial number of people on low incomes use high-cost options

Home credit, the traditional high-cost credit product is now used by 2.4 million individuals, 2.2 million of whom are low-income users (i.e. 90 per cent of customers are in the lowest 50 per cent of household incomes), 14 per cent of the low-income population

Payday lending now serves about 1.8 million individuals, with 70 per cent of users being on low incomes. Payday lending has gone from £100K in 2004 to about £1.2bn in 2011.

Other high-cost credit products include rent-to-own (e.g. Brighthouse) and sale-and-buy-back stores (e.g. Cash Converters). However, both these combined only account for about 4 per cent of the low-income population.

Significant numbers are constrained in their credit options with little choice but to use high-cost options. Some 25 per cent of home credit users and 23 per cent of payday users have no other credit options (Ellison et al 2011). They may have access to credit but at a high-cost.

It is important to note that, even with an expansive sub-prime credit market, there are some people who find it difficult to access credit at all. In general the supply of credit to low-income households is reducing following the financial crisis, with refusals highest for those on the lowest incomes and sub-prime borrowers, 1 million people on low incomes have needed to borrow and been unable to do so in the last 2 years. 1 in 20 (5 per cent) of those who have been refused credit have turned to illegal money lenders (Ellison et al, 2011).

The illegal lending sector is used by 2 per cent of low-income households, some 0.3m, rising to 6 per cent in the most deprived communities. It is concentrated among those without access to legitimate credit. Recent growth in illegal lending is ascribed to shrinking supply of high-cost credit in deprived communities (Ellison et al, 2011).

Social lending by credit unions and CDFIs, despite the expansion of the sector stimulated by the Growth Fund, is still used by only a small percentage of low-income households, even though there are significant regional differences. About 25 per cent of the population of Glasgow are members of credit unions. Overall, however, it is estimated that nationally less than 5 per cent of low-income British households are members of credit unions (this does not include Northern Ireland where 30 per cent of the population are members of credit unions (Jones 2013).

Despite often assumptions to the contrary, the major trend in credit provision to those on low incomes in recent years has been the expansion of access to mainstream overdrafts and revolving credit, now the leading sources of credit even for those on the lowest incomes. Indeed, there is a high degree of cross over between mainstream and non-standard lending, with 58 per cent of non-standard lending users also using mainstream products.

Overdrafts are used by 3.3 million of low-income borrowers as a credit facility with a further one million becoming overdrawn inadvertently, in the course of using a bank account. Credit cards are used by 3.1 million low-income borrowers. Benefit dependent households now represent 24 per cent of low-income credit card holders. (Ellison et al 2011). Two thirds (67 per cent) of low-income credit users, some 6.7m individuals, are subject to behaviour-driven penalty charges on their mainstream credit use, which many are unable to pay off.

Saving and savings accounts

Credit use in the UK is driven, in part, by a lack of a savings net in low-income households and the lack of a strong savings culture in the UK. Two thirds (68 per cent) of low-income households have no savings, rising to three quarters (78 per cent) of those in the lowest income quintile. Only one in six are able to save sufficient amounts to preclude the use of credit (saving more than £300). Seven in ten low-income households would find it difficult or impossible to raise £200-300 in an emergency (Ellison et al. 2011)

The findings of Ellison et al. (2011) are supported by Kempson and Collard (2012) who argue that *"a quarter (25 per cent) of lower-income families do not save at all over the*

course of a year (either formally into a savings account or informally), and a further 38 per cent save only informally, usually in the form of loose change at home".

The lack of a savings culture within British communities, particularly low-income communities, has been noted by a number of researchers (cf. Finney and Davies 2011). Finney and Davies (2011) write in regard to their research into saving on a low-income:

> *"Somewhat ambivalent views were expressed in response to the idea of 'savers' by the focus group participants. So although it engendered some positive and socially desirable qualities, many negative associations with being a 'saver' were also expressed. Moreover, some of the savers interviewed in depth recognised that they had qualities that other people might view negatively. As such, very few focus group participants admitted to identifying with group descriptions of a 'saver' as a whole, tending instead to identify with the 'non-savers' whom they saw as 'normal'. This suggests that there is a need, if not the potential, for changing the public view of 'savers', by emphasising the normality of it and the positive qualities associated with being a saver (regardless of wealth status)" (in executive summary of the report)*

The development of appropriate and accessible savings accounts for people on low incomes remains an area for significant development in the UK. As already noted above, significant work was undertaken into the development of national schemes to assist people to save. The Chid Trust Fund began in 2002 but was concluded for new entrants in 2011. The Saving Gateway was abandoned by the Government also in 2011 due to budget cuts.

It is to be noted that credit unions do prioritise access to savings accounts for people on low incomes and have had considerable success in encouraging Growth Fund borrowers to save (Collard et al. 2010, Jones and Ellison 2012).

Home contents insurance

Despite the development of low-cost insurance products that better meet the needs of tenants living in housing association and local authority homes and that can be paid with the rent, a significant proportion of people on low incomes, remain without home contents insurance. There still appears to be low awareness among tenants of affordable schemes and, in some cases, a lack of effective promotion by social landlords. This is despite the fact that people in social housing are more like to be burgled than people in owner occupation.

Over half of households (52 per cent) in the bottom fifth of the income distribution do not have home contents insurance, equivalent to around 2.6 million households (Parekh et al. 2010, quoted in Kempson and Collard 2012).

Access to debt advice

Access to debt advice has been a key element of financial inclusion activity in the UK. Its expansion was funded through the Financial Inclusion Growth Fund until March 2012 and then funded by Government for another year until 2012.

However, the future of debt advice remains uncertain with many debt advice agencies fearful for their future. Already other Government and local authority funding streams have been cut.

The wish of the Government is fund free face-to-face debt advice through the credit and finance industry. However, this appears not yet to have been actioned.

The reduction of free, face-to-face debt advice in low-income communities is of major significance, particularly at a time when over-indebtedness and financial instability are potentially on the rise as a result of the financial crisis and the introduction of welfare reform (from April 2013).

Q.1.2. Public debate on financial exclusion

The end of the previous Government's Financial Inclusion Taskforce in March 2011 marked a major turning point in the national debate on the promotion of financial inclusion. For six years the Financial Inclusion Taskforce had overseen the range of strategies and interventions to combat financial exclusion and had informed the Government policy agenda as it emerged and developed.

With the election of the new Coalition government, the issue of financial exclusion remained on the public policy agenda, but it would be fair to say not with the same co-ordinated and strategic approach as promoted by the previous administration. Nevertheless, Government has remained an important and significant player in the debate. There was recognition, for example, by the new Government of the value of the DWP Growth fund in the provision of affordable credit in low-income communities and it announced a plan to invest in a three year credit union modernisation project. Equally the importance of debt advice for those on low incomes was recognised and the Financial Inclusion Fund provision extended until 2012 until a new way of funding debt advice through the finance industry could be determined. The need for a financially included population underpins many other areas of Government policy; including welfare reform, the rehabilitation and resettlement of offenders and the need for a financially educated and capable citizenry.

Q.1.2.1. Current debate on financial exclusion

Public debate on financial inclusion is widespread in the UK and tends to focus on the following issues. However, this list is not exhaustive and arises solely from consideration of this issue in relation to the structure of this CAPIC report.

- **Welfare reform.** The introduction of welfare reform and the advent of Universal Credit in 2013/2014 are stimulating an important debate in regard to the financial inclusion needs of social housing tenants. Up to now, social housing tenants in receipt of benefits have had their rent paid directly to the landlord, and their various welfare benefits paid fortnightly either into a bank account or into a Post Office Card Account. With Universal Credit, one payment (including housing benefit (the rental payment)) will be made directly to the tenant once each month. The tenant will then be responsible for paying the rent and managing the household budget on a monthly rather than a fortnightly basis. This will place significant demands on vulnerable tenants. The social housing sector is currently initiating discussions with credit unions and other financial providers to develop transaction and budgeting accounts (Jam Jar Accounts) for their tenants and to provide them with money management support.

  Welfare reform also involves the restructuring of the Discretionary Social Fund. Community Care Grants and Crisis Loans for general living expenses (including rent in advance) will be abolished from April 2013. In its place, a new local provision will

be administered by local authorities in England and the devolved administrations in Scotland and Wales. Local authorities are able to administer grants but they do not have the facilities or expertise to administer repayable crisis loans. A number of local authorities are in discussions with credit unions about their taking on the management of crisis loans, and a number have agreed to do so from April 2013. Crisis loans are emergency loans made to people who have insufficient resources to prevent a serious risk to health or safety to themselves or their family.

- **The development of a responsive bank transaction account**. The introduction of the basic bank account has enabled a significant step forward in the promotion of financial inclusion in the UK. However, the operation of these accounts, as argued elsewhere in this report, has not always been in the best interests of the consumer. Bank penalty charges have been a harsh reality for many people with around a quarter of the newly banked being worse off financially. There is a constant debate on the development of an ideal transaction service for low-income consumers. Kempson and Collard (2011) looked at a number of research studies based on the views of people new to banking (e.g. Bates et al. 2010; Social Finance 2011) and concluded that an ideal account would allow for:

  > *"Deposits, withdrawals at ATMs and also at local Post Offices and Pay Point outlets; a payment card for purchases and use at ATMs; a small buffer zone to permit balances of under £10 to be accessed at an ATM; and the ability to check exactly how much is in the account at will and mobile phone text alerts when the balance is getting low or a major payment is due and there are insufficient funds to meet it; and a new type of automated payment facility that puts more control in the hands of the account holder than direct debits".(Kempson and Collard 2011)*

  This approach to an appropriate basic bank account is borne out by other similar studies (Jones 2010). However, the problem is its implementation. There is some evidence to suggest that banks would like to withdraw from the basic bank account market or at least desist from its promotion. Government is looking to credit unions to offer the kind of account that people seek. However, at the moment, the credit union sector is too small to replace the offer of the high street banks in its entirety, even though some credit unions now count current account holders in their thousands.

- **The development of budgeting or Jam Jar Accounts**. As noted above, this is a key issue for social housing providers. These accounts are so named as they are supposed to copy the way people who operate in cash, set money aside at home for different purposes in different "jars", whether these be mental constructs or actual jars in the home. The idea is that the account holder would make one deposit from welfare benefits or wages into the account, and then the financial provider would pay the rent and other essential bills, the remainder of the deposit would be available for the use of the account holder. The credit union sector is exploring the development of these budgeting accounts.

  However, there are also new entrants into the market who are developing budgeting accounts linking bank accounts or escrow accounts to pre-paid debit cards. These

companies then charge to manage a person's budgeting account (cf. Kempson and Collard 2012).

- **The issue of an interest rate cap on credit.** This is a key issue in the UK at the moment and is hotly contested. Of course a lot depends on where the cap would be set if implemented. The Government has commissioned a study on the impact of an interest rate cap from Bristol University which was published in spring 2013.
- **The problem of payday lending**. Payday lending is seen by many people concerned with the promotion of financial inclusion as a major, toxic problem. Not only is the interest extraordinarily high on these products, often in excess of 4,000 per cent APR, payday loan providers often target, whether intentionally or not, vulnerable people in financial need. Even though payday lenders turn down many people for a loan on the basis of financial insecurity, their modus operandi can often lead people into high over-indebtedness unable to pay off rolled over loans. Payday lending is currently subject to a Government investigation at the moment. A major review was published in March 2013. See section 2.2)
- **The expansion of the credit union sector.** The credit union sector is regarded by Government and many organisations as having the potential to expand services in low-income communities. The Government had just invested £36.5 million in a programme to modernise and strengthen the sector. The Association of British Credit Unions has won the contract to manage the strengthening programme which aims to be in operation from May 2013.
- **The future of debt advice.** The expansion of debt advice services in low-income communities was one of the major successes of the Financial Inclusion Fund, with more than 500 new specialist debt advisers in the voluntary sector appointed to offer debt advice services in low-income communities. These services are now under threat. The Government is seeking a solution in which the financial industry funds debt advice.
- **The future of saving in low-income communities.** This issue of saving has been raised significantly in recent years but few solutions to promoting saving in low-income households have been found. There have been a number of developments, however, in the credit union sector based on deposit-side and withdrawal-side mechanisms to encourage savings. It remains a current issue of debate and has been the subject of a number of research studies (cf. Finney and Davies 2012)
- **Financial inclusion and poverty.** The link between financial inclusion and poverty is part of the current debate. For, even though financial inclusion and poverty are distinct issues, financial exclusion is often a function of poverty. Financially excluded people are likely to be on the margins of society and include those who are unemployed, unable to work through sickness or disability, single pensioners and lone parents and people in in African-Caribbean, Pakistani and Bangladeshi households. Some 70 per cent of financially excluded individuals live in social housing (FITF 2010)

- **Digital inclusion.** The link between digital and financial inclusion is an important current issue, given that welfare benefits will in the future only be able to be applied for online. Modernised mainstream banking and credit union financial services also depend on a digitally included population.
- **Financial inclusion and the criminal justice system.** Several recent reports have focused on the financial inclusion needs of prisoners, ex-offenders and their families. These have focused mostly on access to banking for prisoners and ex-offenders. One recent Ministry of Justice funded report focused on the work of about 15 credit unions in prisons in England and Wales (Bath and Jones 2012). Other reports have focussed on access to basic bank accounts for people in the criminal justice system (Jones 2008b).

Q.1.2.2. Key players in the debate

Most organisations and agencies involved in supporting or working in low-income families and communities are players in the debate around the promotion of financial inclusion. It is a hot topic in the UK and still attracts significant high level support and attention from a range of stakeholders. .

The key players include

- **Local authorities**. Many local authorities support financial inclusion activity under various headings. Liverpool City Council, for example, has recently invested £1 million in the local credit union movement in order to combat high-cost lending. Many credit unions place financial inclusion activity within actions to combat child poverty. Some local authorities take the lead in facilitating financial inclusion in a region. Knowsley Council, for example, in the north west of England leads and services the Liverpool City Region Financial Inclusion Forum.
- **Social housing providers.** Social housing providers are increasingly a lead player in the debate on financial inclusion particularly since the introduction of welfare reform. They realise that without appropriate financial products and services, their tenants will struggle to cope with the introduction of universal credit. They often also provide personal finance educational opportunities to their tenants and access to money and debt advice services.
- **The credit union sector.** The credit union sector is seen by Government and others as key player in enabling low-income communities to access affordable financial services. The sector has just received a £36 million investment from -Government to strengthen its capacity to serve low-income families
- **The social finance sector.** Community development finance institutions, social credit providers and social housing loan providers are central to financial inclusion activity in many areas of the country. These organisations typically provide loans to highly financially excluded individuals.
- **Money and debt advice agencies.** Money and debt advice agencies in the UK are mostly voluntary organisations that focus provision in low-income communities.

Citizens Advice and Advice UK, for example, have taken the lead in expanding debt advice services through the Financial Inclusion Fund. They often work closely with credit unions, local authorities and others in developing local or regional financial inclusion strategies,

- **Prisons and probation services.** Prisons and probation services are increasingly involved in financial inclusion activity as part of their work to resettle ex-offenders effectively in the community.
- **Charities working with the homeless and vulnerable groups.** Homelessness charities such as the Cyrenians in Newcastle and the Passage in London work directly to support homeless and vulnerable people to access and use a bank account as part of their work to stabilise people in the community. They also offer basic financial education to the people they work with.
- **Community and voluntary organisations**. Toynbee Hall, a charitable institution in the east end of London, for example, has established a national forum for financial inclusion (Transact), with a membership of around 1,600 organisations and individuals, many of these are community and voluntary organisations. On a local level, the Greater Manchester Council for Voluntary Service is co-ordinating actions to engage local community and voluntary groups in financial inclusion and money management activity. These groups would include community associations, residents associations, tenants groups, parents' groups etc.
- **Banks and mainstream financial providers.** Clearly banks are involved in financial inclusion activity through the provision of the basic bank account. However, in the UK, apart from the provision of basic banking, they tend to support the activity of the social finance sector rather than develop product and service activity in the low-income market themselves. Banks often fund financial capability education and/or developments on a local level (e.g. Barclays Community Fund and The Co-operative Enterprise Hub). Some other mainstream financial providers support some financial inclusion activity on an ad-hoc basis, but it is not extensive. Some sub-prime lenders have even supported research into the sector. Provident Financial, for example, the leader in the field of high-cost home credit, supported Bristol University to conduct research into saving on a low income (Finney and Davies 2011).
- **Churches and faith groups.** Churches have often been in the lead in the development of the credit union movement in the UK and often actively participate in local financial inclusion activity. There are also some examples of Mosques working with credit unions to develop Sharia compliant credit union products (cf. LASA Credit Union in Swansea).
- **Charitable foundations and trusts.** Grant making trusts such as the Northern Rock Foundation, the Friends Provident Foundation and the Tudor Trust have taken the lead in funding financial inclusion research and local interventions. The Northern Rock Foundation, for example, funds Northern Money and the North East Financial

Inclusion Forum, two financial inclusion co-ordinating bodies in the North East of England.

- **Universities and research agencies**. A number of universities are actively engaged in financial inclusion research and education. Main players include Bristol University, Salford University, Durham University, Birmingham University and Liverpool John Moores University. LJMU runs the only Master's level certificate of professional development in the promotion of financial inclusion in the UK. This course is also delivered at Toynbee Hall in London.

Q.1.3. The importance of affordable personal inclusive credit

The demand for affordable credit is a permanent and essential characteristic of the life of many people living on a low income. There is no indication that the demand and need for credit will go away in the near future and, in fact, for many people, credit is the only way of managing household cash flow and funding major purchases. 69 per cent of low-income households, 10.55m individuals, are credit users (Ellison et al 2011).

There have been some studies that have suggested that, for people on a low income, credit is never affordable and should mostly be avoided (Gibbons et al. 2011). From an analysis of the level of income required to meet basic costs, researchers sometimes conclude that any credit repayments, particularly to high-cost providers, will leave people with insufficient funds to live on and to meet the basic necessities of life. All credit, in this view, is unaffordable to people living on a low welfare benefit level income. This may be technically accurate, but the reality is that people on low incomes do scrimp and save to make ends meet and still find that they need to borrow to balance the budget. And indeed many people get by and meet repayments successfully as the Growth Fund has shown (Collard et al 2010)

It is this fundamental importance for affordable credit in low-income households that has encouraged the Government over the last decade to make access to affordable credit a key focus of policy and to implement various reviews of the low-income credit market and regulatory regime to ensure that access to credit is not to the detriment of the consumer. For certainly low-income borrowers are vulnerable to problem debt and to difficulties arising from the use or over-use of credit.

The cost and affordability of credit is, however, just one issue. It is an important and central issue but cost alone does not tell the whole story. The importance is for affordable personal credit that is responsive to the needs and lifestyle of people on low incomes.

The need is for credit that offers the opportunity of accessing small value loans, often in cash, which offer some flexibility in repayment. The key characteristics that people on low incomes that people seek in credit products, apart from affordability and accessibility, are ease and flexibility of repayment, immediacy of access, familiarity and knowledge of the product, simple and straightforward terms and conditions, convenience, ease of application, a personal service and no stigmatisation in accessing the service (Jones 2001)

Credit meets therefore a constant and often pressing need in low-income households. But it is true that the benefits and risks of credit use are finely balanced. Credit assists people to balance cash flow and meet essential needs but it also adds to the stress on household budgets, reduces disposable income and increases the risk of financial distress and breakdown.

For many people on a low income credit options can often be limited to higher-cost providers such as home credit, goods bought on credit from mail order catalogues or rental purchase shops. Many also, as this report will show, depend on mainstream bank overdrafts and the use of credit cards which also result in high-costs because of people's inability to pay down the debt. But for many this is the only way of managing the budget and the only credit that is available. They manage because affordability is judged not on the long-term cost of the credit product but on the immediate impact of weekly or monthly repayments on the household budget. Weekly or monthly affordability is what counts, not the longer-term overall and total cost of credit. It is because affordability is judged in this way that many people on low incomes are open to exploitation and manipulation by high-cost credit providers. It is for this reason that it is important that people have access to an affordable alternative to high-cost credit, but one that does not result in long-term detriment to household finances.

Q.2 Legal Framework / Regulation

Q.2.1. Businesses authorised by law to provide personal consumer credit

Most businesses that lend money to consumers or offer goods or services on credit or engage in certain ancillary credit activities are regulated under the Consumer Credit Act 1974 and are required to be licensed by the Office of Fair Trading. Trading without a licence is a criminal offence and can result in a fine and/or imprisonment. Businesses cannot legally enforce a credit agreement if they are not licensed.

The 1974 Act was amended by the Consumer Credit Act 2006 which modernised the UK's credit regulation and set out the flexible and market-oriented regulatory regime which governs credit provision in the UK (cf. Ellison et al. 2011).

The legislation allows for any company to engage in credit activity, so long as it has a consumer credit licence and is compliant under the Act. However, any applicant or licensee must be considered fit by the OFT to hold a credit licence. Assessment regarding the fitness of applicants and licensees is based upon:

- *the competence of the trader to carry out a particular activity*
- *any offences committed, in particular any offence involving fraud or dishonesty or violence*
- *failure to comply with relevant consumer credit legislation within the UK and European Economic Area (EEA) state*
- *discrimination undertaken within their business, or*

- *business practices appearing to the OFT to be deceitful or oppressive or otherwise unfair or improper (whether unlawful or not).* (quotation taken from Credit Enforcement Action, OFT website[4])

Legislation does not restrict credit activity, therefore, to banks or mainstream financial providers, and has enabled a wide range of diverse credit granting companies to operate in the UK. The result is that consumers have access to a wide and diverse choice of credit providers, offering a range of terms and conditions.

The legislation does not regulate for the cost of credit and therefore credit companies can and do offer a wide range of APR rates. The cost of credit however must be quoted in a standard manner under the Act to enable consumers make comparisons. In addition, the Consumer Credit Act 1974 enables borrowers to challenge unfair credit agreements in court and obtain redress, if the overall relationship is unfair to the borrower. The amendments made under the Consumer Credit Act 2006 identified the provisions under which a credit agreement would be regarded as unfair.

Credit legislation makes several distinctions between various forms of credit agreement. These include consumer credit agreements, consumer hire agreements, running-account credit and fixed-sum credit, restricted-use credit and unrestricted-use credit and credit token agreements which are agreements for the provision of credit in connection with the use of a credit-token – for example, a credit card.

An important distinction that was to impact significantly on the UK CAPIC project is that between a debtor-creditor (d-c) agreement and a debtor-creditor-supplier (d-c-s) agreement. The OFT describes this distinction in the following terms:

> *A debtor-creditor-supplier (d-c-s) agreement is an agreement made by the creditor under pre-existing arrangements, or in contemplation of future arrangements, between himself and the supplier, or which is financing a transaction between the debtor and the supplier.*
>
> *A debtor-creditor (d-c) agreement is any other kind of credit agreement, including one which is refinancing any existing indebtedness of the debtor (OFT 2010).*

Where a credit provider is providing credit for the purchase of goods, the legislation determines that this is a debtor-creditor-supplier (d-c-s) agreement. In the UK CAPIC project, credit unions provide loans for the purchase of electrical goods through Co-operative Electrical and, as such, are subject to the provisions of the Act for debtor-creditor-supplier (d-c-s) agreement.

The Consumer Credit Act identifies a series of exempt credit agreements. These are not covered by the provisions of the Act. These include agreements secured on land or mortgages, interest-free credit, agreements with only insignificant charges, agreements with employees and other low-cost loans not offered to the general public, agreements connected with a country outside the United Kingdom and agreements for business purposes in which the creditor provides credit exceeding £25,000

Credit union lending is also exempt under the Consumer Credit Act but only for debtor-creditor agreements and where the interest rate charged does not exceed 26.9 per cent APR.

[4] http://www.oft.gov.uk/OFTwork/credit/enforcement-action/

Credit unions are not exempt under the Act where they offer debtor-creditor-supplier (d-c-s) agreements for the purchase of goods. It was this aspect of the legislation that was going to significantly impact on the development of the UK CAPIC project. This was a major learning curve for credit unions on the project, given their exemption from the Act for debtor-creditor agreements. Currently the majority of credit unions, as exempt credit providers, are not licensed under the Act.

Another form of credit agreement that is regulated under the Act but which also has its own legislation is hire purchase. The rules governing hire purchase agreements are contained in the Hire Purchase Act 1984. With hire purchase, the borrower does not legally own the goods until all the money owed is paid back. The contract is with a finance company (not the retailer) who will own the goods until the final payment is made. The finance company can take the goods back if the borrower does not keep up your repayments, but if a borrower has paid more than a third it would need a court order to do so. At the end of this period, the borrower has the option of owning the goods outright, although the lender may require the borrower to pay a fee. Conditional Sale (CS) agreements are similar to hire purchase agreements (HP); in which the borrower owns the goods once all the repayment instalments have been paid. In this case, there is no extra fee to pay at the end. Lenders must give the borrower key information about the contract that he or she can take away and consider before the decision is made to purchase the item.

The Act also regulates the way in which consumer credit licensees carry on business. For example, there are rules on advertising, pre-contract disclosure, credit agreements and post-contractual information. In addition, the Act confers certain rights on consumers, in relation to withdrawal from a credit agreement, early settlement, and section 75 (joint and several liability).

The Consumer Credit Directive, implemented across the EU member states in June 2010 harmonised various aspects of the regulatory framework for consumer credit across the European Union while strengthening consumer protection. Its key provisions are reflected in the 2010 Office of Fair Trading (OFT) Responsible Lending guidance[5]. This provides for the standardisation of the presentation of the price of credit and requires lenders to assess the credit-worthiness of borrowers and to communicate to consumers the likely consequences of using credit products in ways that might be likely to increase its cost.

Q.2.2. The effectiveness of consumer credit legislation

The Office of Fair Trading (OFT) Responsible Lending guidance (2011) also sets out the overarching principles of consumer protection and fair business practice which apply to all consumer credit lending.

However, unfair and illegal practices do continue to the detriment and cost of consumers. This has led not only to the OFT taking action against unfair and illegal credit practices but also to the Financial Services Authority (FSA) conducting research and consultation into

[5] Irresponsible lending – OFT guidance for creditors (March 2010, updated Feb 2011) http://www.oft.gov.uk/shared_oft/business_leaflets/general/oft1107.pdf

consumer credit licensees' activities in order to assist the FSA to develop a new regulatory regime for consumer credit when responsibility passes from the OFT to the Financial Conduct Authority (the body that will replace the FSA) in the near future.

Unfair and illegal practices

The following are a few examples of unfair and illegal practices which have resulted in action being taken by the Office of Fair Trading.

OFT acts to revoke Yes Loans' licence[6] -

The OFT has decided that Yes Loans Limited, one of the UK's largest brokers of unsecured credit, is unfit to hold a consumer credit licence, as are two associated businesses, Blue Sky Personal Finance Limited and Money ***March 2012****Worries Limited.*

The decision to revoke the licences was taken in light of evidence that Yes Loans has failed to comply with the Consumer Credit Act 1974 and associated regulations, and with requirements previously imposed by the OFT.

The OFT found evidence that Yes Loans had engaged in unfair business practices, including:

- *using high pressure sales tactics to persuade consumers to provide their debit or credit card details on the false premise that they were required for an identity and/or security check*
- *deducting brokerage fees without making it clear that a fee was payable, and/or without the consumer's consent*
- *failing to introduce some consumers to the product originally sought, frequently arranging short-term, high interest, loans instead*
- *misleading consumers into believing it was a loan provider rather than a credit broker*
- *treating customers poorly by not providing refunds in a timely manner.*

Wonga reprimanded[7]

In May 2012, the OFT told payday loan firm Wonga it must improve its debt collection practices after it emerged it had sent letters to customers accusing them of committing fraud. Wonga was told it must not send such letters again or it would face a fine of up to £50,000 for every instance of it breaking the rule.

In March 2013, MCO Capital loses its licence[8]

Online payday lender, MCO Capital Limited ('MCO'), has had its consumer credit licence revoked by the OFT and from today is no longer permitted to make regulated loans to UK consumers. Today's news follows the recent OFT payday lending review report, which uncovered evidence of widespread unfair business practices in the sector.

In August 2012, the OFT found that MCO had failed to put in place adequate identity checks for loan applicants. It is thought that this failure led to MCO being targeted by fraudsters who used the personal details of over 7,000 individuals to apply successfully for loans totalling millions of pounds. The OFT also found that MCO had engaged in unfair business practices by writing to people who it was aware may not have taken out loans, asking unequivocally for repayment. MCO ignored OFT requests to stop this practice.

Additionally, the OFT found that MCO lacked the necessary skills, knowledge and experience to run a consumer credit business.

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[6] http://www.oft.gov.uk/news-and-updates/press/2012/15-12#.UVsc4WxwZjo
[77] http://www.oft.gov.uk/news-and-updates/press/2012/40-12#.UVsdVmxwZjo
[8] http://www.oft.gov.uk/news-and-updates/press/2013/23-13#.UVsdt2xwZjo

For all these reasons, the OFT decided to revoke MCO's consumer credit licence. MCO appealed the OFT's decision, but with effect from today withdrew its appeal. MCO is continuing to appeal the OFT's decision to impose a financial penalty of £544,505 for breaches of the Money Laundering Regulations 2007

Loan shark victim helps jail his tormenter.

The following quotation is taken from the Guardian of the 26th June 2012.

'Mike' ended up paying over £90,000 over 17 years after buying car for £250 and tried to kill himself over stress and threats.' Mike' has been given a new identity and been praised for being brave enough to give evidence against the loan shark.

A man who paid more than £90,000 to a loan shark after borrowing just £250 has been given a national award for helping to bring the illegal lender to justice.

The Suffolk man known only as "Mike", has been relocated to protect his family. He reported the loan shark to the national Illegal Money Lending Team and gave evidence against him after the lender threatened his wife and children.

Mike was just 20 when he bought a car for £250 from a friend of the family. But the friend turned out to be an illegal money lender, and over the next 17 years Mike paid back an estimated £90,000 pounds, suffered a heart attack because of the stress and tried to take his own life. He lost his house, his job and very nearly his family. The illegal money lender even attacked him in front of his children.

Mike started by paying back £30 a week, but the loan shark soon demanded ever increasing payments. "After a couple of weeks it went up to £50, £60, £70. I was using money to pay him instead buying food, gas, electric or paying the rent." he said.

Mike added that he had to borrow more from the loan shark to keep up with the payments. "He was chucking interest on top and if you couldn't pay him one week, he would double what you owed him. It just spiralled out of control."

Whenever Mike asked the loan shark how much he owed, he was told £9,000, regardless of how much he was paying back. "He started to give threats, saying if we didn't pay him he'd hit us or take things out of the house, which he did do. He took the kids' PlayStation consoles, the car. There was one occasion when I was ill on the settee and he just laid into me in front of the kids.

"I thought about going to the police but I was worried about the consequences because we were living on the same estate."

The pattern of friendliness leading to a casual loan with no paperwork, followed by increases to the loan, scant information about what is owed or being charged and intimidation is classic behaviour for a loan shark according to the government's Stop Loan Sharks campaign

Mike was doing two jobs to keep his wife and three children going and to meet the demands of the loan shark. "I was working in the warehouse at Asda at night then going to the local primary school to work as a teacher's assistant in the day. I was getting a couple of hours sleep a day and living on Mars bars for energy."

But payments had risen to £200 a week and Mike could no longer pay the mortgage. His family lost their home. "I tried to hang myself in the loft but was stopped so I went to the park to kill myself there and would have gone ahead with it but for the police," he said.

Mike left home but returned on Fridays to visit his children. One afternoon the loan shark was waiting outside for him. "He said if you don't pay up I'm coming for your wife and kids. That was the final straw."

He had read an article in his local paper about a loan shark in Ipswich being prosecuted and jailed, so contacted the Illegal Money Lending Team, a scheme funded by the Department of Business, Innovation and Skills which works in partnership with local trading standards offices.

> *His action resulted in the loan shark going to prison for eight months for illegal money lending and money-laundering. Mike said eight months does not seem long given the misery he and his family suffered for 17 years. "It was a living hell," he said, and even after the loan shark was jailed, his family continued to receive threats via Facebook.*

Government reviews into consumer credit protection

The UK Government has undertaken a number of reviews into consumer credit protection. The most important at the time of writing of this case study are:

<u>Review of high-cost credit; June 2010</u>[9]

This review found that the markets for high-cost consumer credit were working reasonably well but it did recognise that competition on price is not effective and that the cost of credit is high. The following are the main findings and recommendations of the 2010 review:

> *1. In some respects, the markets for high-cost consumer credit can be seen to be working reasonably well.*
>
> *2. The OFT does, however, have some concerns in relation to these markets arising from this review:*
>
> - *On the demand side, the relatively low level of ability and effectiveness of consumers in driving competition between providers, given their low levels of financial capability.*
> - *On the supply side, sources of additional supply such as mainstream financial providers seem to be limited.*
> - *In such circumstances, competition on price is not effective and prices are high.*
>
> *Recommendations*
>
> *The deep-seated nature of the problems identified illustrates the limited possibilities for the OFT, through this review, to make significant improvements to the way in which these markets work. We have made some recommendations for change but recognise that they are likely to bring marginal rather than fundamental improvements.*
>
> *The recommendations that we have made are presented under four headings:*
>
> - *Helping consumers make informed decisions on high-cost credit.*
> - *Increasing consumers' ability to build up a documented credit history when using high-cost credit.*
> - *Improving tools for monitoring the high-cost credit sector.*
> - *Promoting best practice among suppliers of high-cost credit.*

<u>HM Treasury and BIS. A new approach to financial regulation: consultation on reforming the consumer credit regime. December 2010</u>

On 21 December 2010, HM Treasury and the Department for Business, Innovation and Skills published 'A new approach to financial regulation: consultation on reforming the

[9] http://www.oft.gov.uk/OFTwork/credit/review-high-cost-consumer-credit/#.UVshN2xwZjo

consumer credit regime'[10]. This consultation document considered the merits of transferring responsibility for the regulation of consumer credit the Office of Fair Trading (OFT) to the new Financial Conduct Authority (FCA).

On 26 January 2012, the Government announced that the Financial Services Bill includes provisions enabling a transfer responsibility for consumer credit to the FCA, under the same legislative framework as other financial services, while retaining the existing consumer rights and protections in the Consumer Credit Act 1974 (CCA) .

> *In delivering reform, the Government said it wants to enhance clarity for consumers and businesses and increase confidence in consumer credit regulation. Its ambition is to create a world-class regulatory regime that keeps pace with the dynamic nature of this market; responds to actual or potential gaps in consumer protection; and places a manageable regulatory burden on business. The key objectives that the Government is aiming to achieve are:*
>
> - *clarity, coherence and improved market oversight;*
> - *effective and appropriate consumer protection, including through a responsive and flexible framework;*
> - *opportunities for simplification and deregulation; and*
> - *a proportionate and cost effective regime.*

HM Treasury/BIS Review of consumer credit and personal insolvency. 21 November 2011[11]

The Department for Business, Innovation and Skills and HM Treasury in November 2011 published their formal response to the consumer credit elements of the Government's Review of Consumer Credit and Personal Insolvency. The response builds on a number of Coalition commitments to help consumers make better financial decisions when borrowing money and deals specifically with:

- unfair bank charges;
- introductory discounts when taking out a store card;
- interest rate caps on credit and store cards;
- and other consumer credit issues, including high-cost credit.

The following quotation is taken from the reference to the review on the HM Treasury website. It is to be noted that there is no suggestion of capping the cost of high cost credit.

> *"On unfair bank charges, the Government has worked with industry to address consumer concerns about lack of control and transparency. The response announces additional commitments that will apply across every full-facility current account offered by the major banks, covering 85 per cent of consumers.*
>
> *Consumers will be able to receive an alert from their bank when their balance is low and, in some cases, when they are about to go into an unarranged overdraft; they will know by what time they need to make a payment into their account to avoid charges; and they will no longer*

[1010] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31894/10-1160-new-approach-consultation-reforming-consumer-credit.pdf

[11] http://www.hm-treasury.gov.uk/fin_reform_consumer.htm

be charged for small unarranged overdrafts. Balance alerts will be available from March 2012, with full implementation of the other measures by March 2013 at the latest

On store cards, respondents to the Review were most concerned about the ease with which customers are tempted into expensive credit by retailers offering discounts on their purchases at the time they take out a store card. Following negotiations with the Government, industry has agreed to end the practice of introductory discounts as well as introducing other measures to improve the way store cards are offered

The Government will not be introducing a cap on interest rates on credit and store cards. *Following the review, the evidence showed that a cap would not be in the best interest of consumers as pricing some consumers out of the market could force individuals to seek unregulated or high-cost credit.*

Another issue brought to light by the review was the real concern about the high-cost credit market, in particular its effect on vulnerable people. The Government is announcing that Bristol University's Personal Finance Research Centre (PFRC) has been appointed to carry out research into the impact of introducing a variable cap on the total cost of high-cost credit*.*

The Government has also started negotiations with industry to introduce improved consumer protections in codes of practice for payday lenders and other instant credit providers"

OFT review into payday lending - 24 February 2012

In launching this review into payday lending, David Fisher, director of consumer credit at the OFT, was quoted as saying[12]

'We are concerned that some payday lenders are taking advantage of people in financial difficulty, in breach of the Consumer Credit Act and not meeting the standards set out in our guidance on irresponsible lending. This is unacceptable. We will work with the trade bodies to drive up standards but will also not hesitate to take enforcement action, including revoking firms' licences to operate where necessary.

"We have uncovered evidence that some payday lenders are acting in ways that are so serious we have already opened formal investigations against them. It is also clear that across the sector lenders need to improve their business practices or risk enforcement action.

"I would urge anyone thinking about taking out a payday loan to make sure they fully understand the costs involved so they can be sure they can afford to repay

This review aimed to investigate compliance with the Consumer Credit Act and the OFT's guidance on irresponsible lending. It was intended that evidence gained during the review would be used to drive up standards across the sector and to drive out companies that are not fit to hold consumer credit licences.

There were a number of issues of concern that the OFT said that it would focus on during the review, including:

- Giving loans without first checking adequately that the borrower can afford to repay them.
- Inappropriately targeting particular groups of people with clearly unsuitable or unaffordable credit.

[12]http://www.oft.gov.uk/news-and-updates/press/2012/11-12#.UVsjb2xwZjo

- Rolling over loans so that charges escalate and the loans become unaffordable.
- Not treating borrowers that get into financial difficulties fairly

Information from the OFT website revealed that between April and September 2012 Financial Ombudsman Service received 271 new complaints about payday lending, compared to the 296 it saw during the whole of the previous financial year (2011-12). It upheld more than eight out of 10 cases (81 per cent) in favour of the consumer. Complaints centred around loans being unaffordable, excessively high charges, loan providers not accepting a suitable repayment plan, and consumers who have never taken out a payday loan having their name and details used fraudulently.

On 27 January 2012, the Government published the draft Financial Services Bill. The Bill enables the creation of a new regulatory architecture for financial services and the transfer of responsibility for regulating consumer credit from the OFT to the Financial Conduct Authority.

Outcome of the OFT review into payday lending 6th March 2013[13]

As a result of its review of the payday loans sector, the OFT announced in March 2013 that it was giving the leading 50 payday lenders, accounting for 90 per cent of the payday market, 12 weeks to change their business practices or risk losing their licence. The OFT reported that it had found evidence of widespread irresponsible lending and failure to comply with the standards required of responsible lenders. The OFT also announced that it proposed to refer the payday lending market to the Competition Commission after it found evidence of deep-rooted problems in how lenders compete with each other.

The review found evidence of problems throughout the payday lending sector, from advertising to debt collection. The particular areas of non-compliance that it identified were:

- lenders failing to conduct adequate assessments of affordability before lending or before rolling over loans
- failing to explain adequately how payments will be collected
- using aggressive debt collection practices
- not treating borrowers in financial difficulty with forbearance.

The 50 leading lenders have to act quickly to address specific concerns identified by the OFT in relation to their businesses. They were informed that they had 12 weeks to become fully compliant, or risk losing their licence.

The review reported that payday lending is a top enforcement priority for the OFT as customers often have limited alternative sources of credit and are frequently in a vulnerable financial position. The OFT also noted that the high rates of interest charged by many payday lenders can make the consequences of irresponsible lending particularly difficult for borrowers. The OFT found that lenders competed by emphasising the speed and easy access to loans rather than on price and also that they relied too heavily on rolling over or refinancing loans. The OFT said that it believed that both these factors distort lenders' incentives to carry out proper affordability assessments as to do so would risk losing business to competitors. The OFT maintained that too many people are granted loans they

[13] http://www.oft.gov.uk/news-and-updates/press/2013/20-13#.UVslq2xwZjo

cannot afford to repay. Despite payday loans being described as one-off short term loans, costing an average of £25 per £100 for 30 days, up to half of payday lenders' revenue comes from loans that last longer and cost more because they are rolled over or refinanced. The OFT also found that payday lenders are not competing with each other for this large source of revenue because by this time they have a captive market.

Q.2.3. Consumer credit legislation and exceptions

Q 2.3.1 Interest rate cap applicable to personal consumer credit

There has not been an interest rate cap on loans in the UK since 1974 when a 48 per cent upper limit on interest was abolished. This led to a rapid expansion of the credit market and to a range of providers offering short-term loans at high rates of interest. Today home credit loans are offered around 300 per cent APR and payday loans can reach 4,000 per cent APR. However, many people believe that the government should reintroduce an interest rate cap as part of its review of consumer credit. Such "caps" on interest rates apply in several other European countries including France, Finland, Germany, Greece, Holland, and Italy. These caps are seen to reduce irresponsible lending and detriment to borrowers.

The question of an interest rate cap has been discussed in the UK at least since 2004 when a report by Policis questioned its effectiveness. Many consumer organisations, including Citizens Advice, have also resisted the introduction of a cap on the grounds that it would curtail access to credit for many people. Speaking in 2004, Elaine Kempson, Director of the Personal Finance Research Centre at Bristol University said,[14].

> *"An interest-rate cap sounds a very attractive idea. It's only when you start unpeeling things that you can see how it would actually impact on poor people and I think they would be the losers."*
>
> *"I think what we'll see is that some of the lenders who give cash loans will simply withdraw from the market and therefore they will be much more likely to have to go to unlicensed lenders. We'll also see lenders getting round the interest-rate cap and imposing charges in other ways."*

In order to explore once again the issue of an interest rate cap on loans, the Government commissioned Bristol University to undertake a study into all aspects of the issue. This report, *The impact on business and consumers of a cap on the total cost of credit* (BIS 2013), highlighted the detriment of high cost credit on UK households face brought about through the cost of credit and also through the way in which lenders assess affordability, multiple and repeat borrowing and loan renewals.

However the Bristol University report again concluded that the imposition of a cap may not be in the best interest of borrowers. It argued that short-term lenders may migrate towards the level of the cap and thus increase the cost of credit for consumers. Others may migrate away from the market altogether thus reducing access to credit for many. Yet others may introduce default charges and just ensure that borrowers paid higher costs irrespective of the cap. The report concluded:

> *The evidence reviewed for this research does not show unequivocally that price restrictions (in the form of interest rate restrictions) reduce the cost of borrowing to consumers, particularly*

[14] http://news.bbc.co.uk/2/hi/programmes/moneybox/3643549.stm

those on low incomes. There is no evidence about the proportion of customers who actually pay less for short-term credit after interest rate restrictions are introduced than they did before.

The Government made a response in its publication, "High cost credit report by Bristol University: government response (BIS 2013). The following quotations illustrate the Government's position:

> *The Government does not believe that a cap on the total cost of credit would be the best solution now to the problems that have been identified by the Bristol report and the OFT payday compliance review. However, the Government recognises that a cap might be appropriate at some point in the future. This is why we have provided the FCA with specific powers to impose a cap on the cost and duration of credit, should they deem it appropriate once they take over the responsibility for consumer credit in April 2014.*
>
> *Government believes that tough enforcement and compliance action today, combined with a move to a new consumer credit regulatory regime that is equipped to deliver more robust consumer protection in the future, will do much to address the key concerns in this market. It will weed out rogue lenders, ensure that consumers have tools to make the right borrowing decisions for them, and provide important protection and help for consumers who find themselves in difficulty.*
>
> *The findings of the Bristol report indicate that a variable cap on the total cost of credit in the short term credit market would not be the best way of addressing the causes and consequences of detriment in this market. The findings suggest that such a cap could reduce access to credit, reduce the supply of credit and weaken competition. It could also lead lenders to shift more to charges which fall outside the cap and to optional fees which are generally less transparent to consumers and therefore less conducive to competitive pressures. Consumers who cannot repay on time may also be shown less forbearance by lenders. It could stimulate the growth of other markets which carry a risk of consumer detriment, for example the sale of goods at higher prices for payment by instalments.*
>
> *The Bristol report further concludes that there is a role for short term credit in the UK's credit market. The report found that this type of credit provides consumers with quick and straightforward access to funds at a time when they can be most in need. It also found that these forms of credit fill an important gap not covered by high street banks. Banks tend not to offer such ease of access to their credit products (such as credit cards or overdrafts) that might be attractive to consumers who are looking for low value, short term credit The report also points to high levels of customer satisfaction with short term credit providers. In particular, they highlighted the convenience of taking out such loans and the good service they experienced. Consumers in the main had a clear understanding that short term credit can be expensive but nevertheless found it useful for their specific needs.*

Interest rate cap on credit union loans

In the discussion on the cap on interest on loans, what this cap might be does not seem to have been explored in any depth. It is important to note that even affordable lenders charge much higher rates than in continental Europe. Some community development finance institutions charge up to 100 per cent APR on low value loans and these organisations are seen as ethical and affordable lenders and of service to people on low incomes.

Currently credit union loans are capped at 26.8 per cent APR. There is a current Government consultation to raise this cap to 42.6 per cent APR. The reason the DWP wishes to support the raising of the cap of a credit union loan to 42.6 per cent APR is to widen access to affordable credit to many more people who currently have little choice but to access high-cost credit. This consultation seeks views on the proposal to increase the

maximum interest rate that credit unions can charge, from 2 per cent per month to 3 per cent per month. This consultation was issued on 18 December 2012 and closed on 18 March 2013.This consultation was set out in the following terms[15]:

> *The Government has today published a consultation on raising the maximum interest rate cap for credit union loans. This consultation seeks views on the proposal to increase the maximum interest rate that credit unions can charge, from 2% per month to 3% per month.*
>
> *The rationale for this proposal was explained in detail in a Feasibility Study commissioned by the Department for Work and Pensions (published in May 2012) which found that credit unions are currently unable to break even on small, short-term loans. This leads to a lack of stability in the sector, which is damaging for the long-term future of credit unions.*
>
> *Allowing the maximum rate of interest to increase will enable credit unions to become more stable over the long term. This means that low income consumers will have greater access to reliable, affordable credit, without having to resort to more expensive means, such as home credit or payday lenders, or worse, illegal lenders.*
>
> *It is important to note that this increase in the interest rate would be permissive; it does not require credit unions to increase the interest rate they charge but simply permits them to do so if they judge that the benefits outweigh the costs. As such, the measure eases an existing regulatory burden on credit unions*

In the next section it is shown that a £400 currently costs £125 to borrow from a payday lender for a month If a credit union was to make a £400 loan for a month at 26.7 per cent APR (2 per cent per month), the total interest chargeable would be £8. A credit union with paid staff could not offer such a service for only £8. It would not be economical. At 42 per cent APR (three per cent per month), the £400 credit union loan for one month would cost £12. This is still not really economically viable for a credit union, but it is better than £8 and nothing like £125 charged by the payday lender.

If credit unions were to offer loans at the same rate as some European CAPIC participants, the business would not be viable. Take a European example of a CAPIC project offering credit at 2 per cent APR, on the £400 loan for a month, the credit union would make in interest about 70 pence. No business could offer payday loans of £400 for a month at 2 per cent APR and make 70 pence. This would hardly pay for the postage stamp and the phone call. If a cap were introduced, therefore, it would have to take into account the operating costs of low value short term loans.

Q 2.3.2. Illustrations of the cost of credit

The following are illustrations of the legal cost of credit for a typical low-value loan from two high-cost alternative lenders and from a credit union.

It should be noted that there are usually no penalties for late payment of a home credit loan (Ellison et al. 2011). Ellison found that a good home credit borrower only pays six times in ten – which in fact in practice reduces the APR rate charged.

The penalties for the non-payment of a pay-day loan can be high, with various late charges added to the account. Payday lenders have direct access to a borrower's bank account and increased charges can occur through the imposition of bank charges for failed direct debits.

[15] http://www.hm-treasury.gov.uk/consult_creditunion_cap.htm

Late payment for a credit union loan results in an increased interest charge to the borrower as charges are calculated on a daily basis. This is dealt with in other sections of this case study

Fig 1 –A £400 home credit loan repaid weekly (Provident Financial)

APR	***Loan amount***	***No. of payments***	***Paid***	***Each repayment***	***Total Amount repaid***	***Total Interest payable***
272.2 per cent	£400.00	52	weekly	£14.00	£728.00	£328.00

Fig 2 –A £400 payday loan repaid after one month (payday loans are short term products)(Wonga)

APR	***Loan amount***	***No. of payments***	***Paid***	***Each repayment***	***Total Amount repaid***	***Total Interest payable***
4,214 per cent	£400.00	1	month	£525.48	£525.48	£125.48

Fig 3 – A £400 credit union loan repaid weekly

APR	***Loan amount***	***No. of payments***	***Paid***	***Each repayment***	***Total Amount repaid***	***Total Interest payable***	
12.7 per cent	£400.00	52	weekly	£8.17	£424.84	£24.84	Standard member rate
26.8 per cent	£400.00	52	weekly	£8.67	£450.84	£50.84	Growth Fund rate (low value high risk loans)
42.6 per cent	£400.00	52	weekly	£9.18	£477.36	£77.36	Proposed rate – DWP expansion project

"A typical home collected credit loan charges 254.5 per cent APR, on a £400 loan over 50 weeks. This works out as a total repayment of £700, and a cost to the customer of £75 per £100 borrowed.

If a credit union could charge 3 per cent per month interest (equivalent to 42.58 per cent APR) on a £400 loan over one year then this would result in a total repayment of £477.36, and a cost to the consumer of £19.34 per £100 borrowed.

A typical payday lender (which is not directly comparable, as payday loans tend to be made over one month, rather than one year) would charge the equivalent of 1,410.3 per cent APR on a loan, which works out at a £25 cost per £100 borrowed over the course of one month. However, if the loan is rolled over only once, the cost doubles to £50 per £100 borrowed over the course of two months" Ellison et al 2011

Q 2.3.3. Particular legislation depending type of credit or type of credit provider

This is covered in other places in the report – see section 2.1

Q.2.3.4. The regulation of hire purchase

This is covered in other places in the report - see section 2.1

Q.2.4. Risk assessment, financial capacity assessment, responsible practices

Q.2.4.1. Assessment of credit risk and/or creditworthiness

The Office of Fair Trading has published guidance on responsible lending in its publication "Irresponsible lending – OFT guidance for creditors" (2011). This guidance provides clarity for businesses and consumers as to the business practices that the OFT considers constitute irresponsible lending practices. The guidance sets out the standards the OFT expects from businesses engaged in lending if they are to be considered fit to hold a licence. It covers the entire lending process from the initial lending decision up to the handling of arrears and defaults.

Section 4 of the guidance notes considers assessment of affordability which deals with the assessment of credit risk and credit worthiness.

The following in a summary of the contents of Section 4 of the guidance notes:

> 4.1 Before granting credit or increasing the amount of credit, creditors should assess a prospective borrower's ability to meet repayments over the life of a loan in a sustainable manner. All such assessments of affordability should involve a consideration of the impact of the loan on the borrower's overall financial well-being. It is not sufficient to solely assess the likelihood of the borrower being to repay the loan in question – which would only constitute one aspect of such an assessment.
>
> 4.2 The OFT would regard 'in a sustainable manner' in this context as constituting:
>
> - without undue difficulty

- within a reasonable period of time
- out of income and/or available savings, without having to realise security or assets30
- without incurring any/additional problem indebtedness.

4.4 All assessments of affordability should be based on the premise that the borrower should be able to repay the credit over the term. In the case of running account credit, where there is no fixed-term, the assessment should be based on an ability to repay an assumed drawdown (equivalent to the credit limit where there is one) over a reasonable period.

CONSTITUENT ELEMENTS OF AN ASSESSMENT OF AFFORDABILITY

4.7 The extent and scope of any assessment of affordability, in any particular circumstance, should be dependent upon – and proportionate to – a number of factors, including, but not necessarily limited to the following:

- The nature of the credit product.
- The amount of credit to be provided and the associated cost to the borrower
- The borrower's financial situation.
- The borrower's credit history including any indications of the borrower having experienced existing or previous financial difficulty.
- The borrower's existing- and predictable future- financial commitments including any repayments due in respect of other credit products and the borrower's principal non-credit commitments.
- The impact of any reasonably foreseeable change in relevant circumstances on the borrower. This would include both changes to the borrower's own personal circumstances and, where appropriate, wider economic changes. A change in circumstances is unlikely to be considered to be 'reasonably foreseeable' unless it was known to be happening, or reasonably should have been anticipated, at the time that the assessment of affordability was undertaken. Relevant changes of circumstance would include a predictable end point of current employment due to circumstances such as retirement or the conclusion of a current employment contract with a specified finite time – either of which may lead to a fall in the borrower's disposable income.
- The vulnerability of the borrower. For example, whether the borrower has, or appears as if he may have, mental health problems which could impact on his capacity to be able to understand information and explanations and make informed decisions based on his understanding of such information and explanations.
- The borrower's actual or apparent financial capability.

4.8 Creditors may employ the use of a variety of types and sources of information to assess affordability. Such information might appropriately include some or all of the following (this is a non-exhaustive list):

- evidence of income
- evidence of expenditure
- a credit score
- a credit report from a credit reference agency
- information obtained from the borrower, whether on the application form or separately

4.9 In some instances, the creditor's standard assessment of creditworthiness may be sufficient to also assess the issue of affordability whilst in other instances it is unlikely that this will be the case. Whatever means and sources of information creditors employ to assess affordability should be sufficient to make an assessment of the likely impact of the loan on the borrower's overall financial well-being.

4.11 In taking expenditure into account in assessing affordability, such considerations should take into account not only regular household expenditure and relatively fixed outgoings (monthly rental payments for example) but also the varying nature of certain items of expenditure over the anticipated repayment period (for example utilities bills). The assessment should not be based on a presumption that the most recent payment necessarily represents 'the norm' for the entire term of the loan.

4.12 Creditors who do not require documentary evidence of income and/or expenditure as part of their assessment of affordability, but rather accept the information communicated by the borrower in the absence of any supporting evidence or, in the alternative, do not seek any information on income and/or expenditure as part of their assessment, must ensure that whatever other means and sources of information they employ are sufficient to make a proper assessment. Self-certification of income would not generally be considered adequate in respect of large long term loans, particularly those secured on property.

4.15 A high level of scrutiny should normally be undertaken in the case of secured loans whereby homeowners with a first mortgage access further borrowing secured by a subsequent charge on their property. This should also be the case where unsecured debt is consolidated into a secured loan.

The above guidelines are generally agreed to reflect good practice within the credit granting industry and would form the basis, for example, of a credit union's approach to the assessment of risk. Of course, in practice some lenders do not operate to the standards of the guidelines and thus fail as responsible lenders.

In addition to the assessment of affordability, the guidelines also cover:

- 2 General principles of fair business practice
- 3 Explanations of credit agreements

- 5 Pre-contractual issues
- 6 Contractual and post-contractual issues
- 7 Handling of default and arrears 5
- 8 Regulatory compliance

It is worth stressing that credit scoring is a system often used to decide how much of a risk is making a particular loan to a particular potential borrower. Recently, the credit union sector in the UK has developed its own credit scoring system in collaboration with Experian, one of the three credit reference agencies in the country.

When a person apples for credit, he or she completes an application form. This tells the lender many things about the applicant. Each fact about the applicant is given points. All the points are added together to give a score. The higher the score, the more credit worthy the applicant is. Creditors set a threshold level for credit scoring. If the applicant's score is below the threshold, the lender may decide not to make the loan or to charge you more if they do.

Different lenders use different systems for working out the credit score. Normally creditors will not tell the person what their score is but if asked, they must tell the applicant which credit reference agency was used to get the information on which the score is based. The applicant can then check whether the information the lender used is right or not.

In fact, because creditors have different systems to work out credit scores, a person may be refused by one creditor, but not refused by others.

The introduction of credit scoring into the credit union system in the UK is just in its infancy, but is seen as a major element in the modernisation and expansion of the movement. Of course, the lender can always make a personal decision whether to make the loan or not, irrespective of the credit score. The credit score only gives a further indication of the level of risk involved.

Q.2.4.2. UK Credit reference agencies

There are three credit reference agencies in the UK. These are Experian, Equifax and CallCredit. They are all private companies. There is no national state credit reference agency

These agencies are allowed to collect and keep information about a consumer's borrowing and financial behaviour. They hold credit files on the borrowing records of nearly every adult in the UK. They do no more than supply information to lenders. The lenders use the information as part of their credit scoring. Credit Reference Agencies do not offer an opinion on the credit worthiness if the applicant and it is the credit provider who either approves or declines the application for a loan based on the information provided.

With most mainstream credit providers, and some sub-prime providers, the applicant for a loan has to give permission for the lender to check information on his or her personal credit reference file. The credit provider will then use this information to make a decision about whether or not to make the loan. Credit unions, for example, often check a loan applicant's credit reference file to inform decision making. If a lender refuses the loan after checking the credit reference file, the credit provider must tell the applicant why credit has been refused

and give details about which of the three credit reference agencies has been used. Lenders can consult one or more credit reference agencies when making a decision about a loan.

The credit reference agencies keep the following information[16]:

- The Electoral Roll. This shows addresses the applicant has been registered to vote at and the dates the person was registered there
- Public records. This includes court judgments, bankruptcies and in England, Wales and Northern Ireland, IVAs, Debt Relief Orders and Administration Orders. In Scotland it includes decrees, sequestration orders, DAS Debt Payment Programmes and Trust Deeds
- Account information. This shows how the applicant has managed existing accounts such as bank accounts and other borrowing. It shows lenders whether or not the applicant has made payments on time
- Home repossessions. This is information from members of the Council of Mortgage Lenders about homes that have been repossessed
- Financial associations. This shows details of the people the applicant is financially connected to. For example, it includes people that the applicant has applied jointly for credit with or with whom he or she has a joint account.
- Previous searches. This shows details of companies and organisations that have looked at information on the applicant's file in the last 12 months
- Linked addresses. This shows any addresses that the applicant has lived at
- Fraud against the person. If there has been any fraud against the applicant, for example if someone has used his or her identity, there may be a marker against the applicant's name to protect the applicant. The applicant can see this on the credit file.

Information about an individual is usually held on a credit reference file for six years. Some information may be held for longer, for example, where a court has ordered that a bankruptcy restrictions order should last more than six years. If information is held for longer than it is supposed to be, the individual can ask for it to be removed.

Any individual can ask for a copy of his or her credit reference file from any of the credit reference agencies. If a person has been refused credit, the applicant can find out from the creditor which credit reference agency they used to make their decision. An individual has to pay a small fee of £2.00 to get a copy of his or her credit reference file.

If a person thinks that any of the information held on their credit reference file is wrong, they can write to the credit reference agencies and ask for it to be changed. Individuals can also add extra information about their situation. For example, they can add information if they have had a past debt but have now paid it off. This is called a notice of correction. This might help an individual if he or she applies for credit in the future.

[1616] Cf. The author is grateful to Citizens Advice for the information in this section: http://www.adviceguide.org.uk/england/debt_e/debt_borrowing_money_e/how_lenders_decide_whether_to_give_you_credit.htm

When lenders search an applicant's credit reference file, they may find a warning against the name if someone has used the applicant's financial or personal details in a fraudulent way. For example, there may be a warning if someone has used the applicant's name to apply for credit or forged their signature. There might also be a warning against the applicant's name if the applicant has done something fraudulent.

To be able to see this warning of fraudulent activity, the lender must be a member of CIFAS[17] the UK's Fraud Prevention Service. This service is used by financial companies and public authorities to share information about fraudulent activity. CIFAS is not a credit reference agency. The information it provides is only used to prevent fraud and not to make lending decisions.

If there is a warning against an applicant's name, it means that the lender needs to carry out further checks before agreeing to the application. This may include asking the applicant to provide extra evidence of their identity. If there is a CIFAS warning against an applicant's name, they will be able to see this on the credit file. If an applicant is an innocent victim of fraud, CIFAS members must also send the applicant a letter stating that there is a CIFAS warning against their name. A CIFAS Member is not allowed to refuse a loan application, just because there is a warning on a credit reference file. The lender must make further enquiries to confirm personal details before making a decision.

Q.2.4.3. Regarding debt relief schemes

There are a number of debt relief schemes operating in the UK. The following are the most important options[18]. The most suitable option for any individual person depends on whether or not he or she has money or an income to pay off the debts.

Agreements with individual creditors

If a person has money or an income to pay off debts, the most common arrangement is to come to agreements with individual creditors. Debt advice agencies, such as Citizens Advice Bureaux, will assist a person to sort out their debts into priority and non-priority categories and then often make contact with creditors on behalf of the person in financial difficulty (alternatively the person make contact with creditors by him or herself).

The advice agency, or the individual person, will then endeavour to come to a repayment agreement with the creditor. Normally this will be based on reduced loan repayments over a longer period. Advice agencies will advise that people make sure that they deal with any urgent, priority debts first. These include such debts as mortgage, rent and council tax debts. By not paying such debts people risk losing their home, or even their liberty in the case of council tax debt.

Credit union debts are always considered by advice agencies as a non-priority debt. This means that default on loans made through the CAPIC project are at greater risk of non-payment if the person falls into financial difficulties.

[17] Originally CIFAS was the Credit Industry Fraud Avoidance System
[18] The section owes much to information supplied by Citizens Advice, UK.

In some circumstances, if a person has no money to pay off debts, creditors may agree to write off debts and stop action against the person altogether. This is most likely to happen if the person is on a low income and their situation is particularly difficult and unlikely to get better. For example, a debtor may have long-term serious health problems or be very elderly. Normally the debtor will need to show proof of their situation, for example, medical evidence, before creditors will agree to write off debts. Some creditors may want a debt adviser to make this request on behalf of an applicant

Debt management plans

If a person has enough money left over after paying priority creditors and essential expenses, they may be able to arrange a debt management plan. A debt management plan is an arrangement with creditors to pay back the debt by regular instalments. However, instead of the person in debt speaking to the creditors themselves to arrange the plan, a Debt Management Company (DMC) does it for them.

Usually person has to pay for this service, as most DMCs are private companies, although there are some DMCs who will organise and manage a plan for free. The free companies include StepChange Debt Charity and PayPlan.

The advantages of using a DMC are that the person only makes one payment direct to the DMC. The company then divides the payment fairly between all the creditors

However there are also disadvantages to using a DMC. Most DMCs charge an upfront fee which can be quite high thus leaving the debtor with less money to pay off their debts. Also most DMCs also charge an administration fee to the customer each month. This leaves the person with even less money to pay off your debts. Some DMCs take all of the first month's payment as a fee. This puts a person's account into arrears by a month or more. These arrears will be recorded on the person's credit reference file.

It is important to note that DMCs only deal with non-priority debts and priority debts will have to be dealt with separately.

In 2010, the Office of Fair Trading (OFT) published a warning to 129 fee charging debt management companies to start complying with consumer credit regulations or face losing their consumer credit licence. In 2011, the OFT released a statement announcing that 35 debt management companies have surrendered their consumer credit license and have ceased trading. The OFT report highlighted the following significant areas of non-compliance:

- Misleading advertising, in particular not disclosing a fee and misrepresenting the services as being free when they were not.
- Frontline advisers lacking in competence and providing poor advice based on inadequate information.
- Lack of mention of the Financial Ombudsman Service (FOS) for resolving consumer complaints.

Administration Orders

An individual may be able to apply to a county court to have all their non-priority debts put together into one affordable monthly payment. This is called an Administration Order. This depends on the person having sufficient money left over to pay priority creditors and essential expenses.

A person can apply for an Administration Order if their total debts are less than £5,000 and they have a county court judgment (CCJ) against them. The court decides what a fair amount to repay depending on a person's income. The court can agree that the person only pays part of the total debt. This is called a composition order.

Once the order is agreed by the court, the person makes one regular payment to the court and creditors cannot take any further action to get their money back, as long as the person keeps to the agreed payments.

Individual Voluntary Arrangements (IVAs)

If somebody has enough money left over after paying priority creditors and essential expenses, they also may be able to arrange an Individual Voluntary Arrangement (IVA).

An IVA is a legal agreement with creditors (usually non-priority creditors) to repay debts, either in part or in full. The IVA arrangement is negotiated, written up and checked regularly by an independent solicitor or accountant called an Insolvency Practitioner. However, not all the creditors have to agree to an IVA arrangement, as long as the creditors to whom the person owes 75 per cent of their debts agree.

The costs of setting up an IVA can be high and an upfront fee may be charged. If a person does not keep to the payments, he or she can be made bankrupt.

In Scotland, the equivalent of IVAs are known as Trust Deeds.

Consolidation loans

Another option for people who have sufficient money left over after paying their priority creditors and essential expenses, is to take out a loan to pay off non-priority debts. This is called a consolidation loan. Typically consolidation loans are used to pay off debts on credit cards and unsecured loans.

There are many companies offering consolidation loans, but it can sometimes be very risky for people. Many creditors offering consolidation loans ask for the new loan to be secured against a person's home. This means an unsecured debt becomes secured debt on a property and the person could lose their home if they do not keep up with the payments.

However, if a person can afford the repayments, has stable finances and is good at controlling spending, a consolidation loan can be a way forward.

Debt relief orders

If a person cannot pay off his or her debts at all, they may be able to apply for a debt relief order (DRO). A DRO is granted by the Insolvency Service and is a cheaper option than going bankrupt. It usually lasts for a year and during that time, none of the creditors can take action against the person in debt to get their money back. At the end of the year, the person is free of all the debts listed in the order.

To qualify for a DRO, a person needs to have debts of £15,000 or less, have spare available monthly income of £50 or less after paying household bills, have assets and savings of less than £300 (this does not include a car as long as it is worth less than £1,000). People are not eligible for a DRO if they have recently been made bankrupt or have gone through another sort of insolvency procedure such as an Individual Voluntary Arrangement.

People can only apply for a DRO through an authorised adviser. DROs are only available in England and Wales. The Scottish equivalent of a DRO is LILA (Low Income Low Asset) Bankruptcy

Bankruptcy

If a person has no money left over to pay your debts, or has so little that it would take many years to re-pay the debts, bankruptcy can be an option. It is a more expensive option than a DRO but many people do not qualify for a DRO.

Going bankrupt takes pressure off creditors away a person who is allowed to keep certain items, like household goods and a reasonable amount to live on.

When the bankruptcy order is over, a person make a fresh start and the debts are usually written off. In many cases, this can be after only one year. Creditors have to stop most types of court action to get their money back following a bankruptcy order (but in some cases the bailiffs may still be able to take belongings away). It is a serious option as it can have long-term impact on a person's credit rating.

Q.2.5. National regulation specificities

The UK CAPIC project is based a partnership arrangement between credit unions and The Co-operative Electrical retail supplier. It aims to enable people on low-incomes obtain credit to purchase household electrical goods at a reasonable. It is a project that is in direct competition to weekly-pay rent-to-own retail stores selling similar items but at a much higher cost. These partnership arrangements are often supported by local authorities and housing associations.

The most significant national regulation that has impacted upon the development of the UK CAPIC project concerns the Consumer Credit Act and Debtor – Creditor – Supplier Agreements

Ordinarily credit unions are not required to comply with the Consumer Credit Act, as two party debtor-creditor credit agreements between a credit union and a member are exempt from the Act. However, agreements involving a supplier where credit is extended under arrangements between the credit union and the supplier on the reasonable expectation that the credit will be used to supply goods to the debtor (member) – known as a debtor-creditor-supplier agreement - are not exempt from the requirements of the Consumer Credit Act.

Credit unions making debtor-creditor-supplier credit agreements such as those in the CAPIC project are required to hold a Category A Consumer Credit Licence and all such loans must be compliant with the requirements of the Consumer Credit Act and other relevant legislation – principally The Consumer Credit (EU Directive) Regulations 2010 which effect the EU's Consumer Credit Directive 2008 and which came into force on 1 February 2011.

These loans if deemed non-compliant could be unenforceable and therefore might have to be written off should they be challenged by the member. Of course those credit unions that are not part of the CAPIC project and which conduct lending under debtor-creditor agreements (loans directly to members) are not required to comply with these regulations.

At the start of the CAPIC project, it is fair to say that most credit unions did not realise that they would have to comply with the Consumer Credit Act as the issue as to whether or not CAPIC loans were judged a Debtor – Creditor – Supplier Agreement was not clear and hotly debated. However, consultation with the OFT determined that CAPIC loans are indeed a Debtor – Creditor – Supplier Agreement and credit unions needed to comply under the Act.

This was a major learning curve for credit unions and has delayed the development of the scheme. New guidance for credit unions on applying for a Category A Consumer Credit licence had to be drawn up and on all the aspects of compliance which, up to now, credit unions had been unfamiliar. These aspects include the required pre-contract and post – contract information that must be given to a borrower, the re-design of credit agreements, and the particular specificities of operating under the Consumer Credit Act.

Q.2.6 Final conclusions

In relation to the legislative framework, the key leaning points on the CAPIC project have been the following

- the importance of knowledge of and compliance with consumer credit legislation. The fact that credit unions were not exempt from consumer credit legislation for the CAPIC project has impacted seriously on its development. Understanding the requirements of consumer credit act compliance in regard to debtor-creditor- supplier agreements has been the most significant learning point on this project.
- the importance of sharing knowledge and information about consumer credit compliance throughout the credit union sector. Different understandings and perspectives on the requirements of the Consumer Credit Act led to confusion and contest. This delayed the national roll-out of the CAPIC project. Out of CAPIC has come a new project, funded through the Co-operative sector to establish standard compliant credit agreements and associated literature. This project will take place in one credit union working in partnership with Co-operative Electrical but the learning and the compliant literature will be designed to inform the entire credit union movement of the practical implications of consumer credit compliance.
- the importance of ensuring national recognition for the CAPIC project and confidence in its viability. It has been clear that the difficulties in regard to legislative compliance have compromised the support of such organisations such as ABCUL. Confidence and trust in the CAPIC project depends on full legislative compliance.
- the importance of the development of strong partnership working between partners with each partner understanding and accepting differing perspectives on project delivery. From the credit union point of view, it has been important that other agencies are fully aware of the need of credit unions to be fully compliant under the Consumer Credit Act.

Q.3. Credit Market Structure Overview

Q.3.1 The diversity of credit provision

The UK"s consumer credit market is one of the most diverse and well established in the world. Despite a downturn in the three years prior to 2011 (pwc 20011), the use of unsecured credit has once again started to grow. Total lending to individuals rose by £1.7 billion in December 2012, up from a £0.1 billion growth in the prior month. In December 2012, the twelve-month growth rate was 0.7 per cent (Bank of England 2012, see table A below).

By December 2012, almost £1,421 billion was lent in unsecured credit, an amount which exceeded that for secured lending (i.e. mortgages) by almost £16 billion. Today, around two thirds of all households borrow money, up from just under half in 2002 (Bank of England)

Within the large and complex unsecured credit market, there is a wide range of consumer credit products including overdrafts on bank accounts, mainstream and sub-prime credit cards, unsecured personal loans from banks and finance companies, home credit, cheque cashing, pawn broking, payday loans and retail finance.

It is within the category of retail finance that is found such credit products as offered by rent-to-own retail shops. These shops offer credit to purchase household goods on a weekly-repay basis. It is within this context of credit for retail household electrical goods that the UK CAPIC project operates.

Bank of England - Lending to Individuals - December 2012

Table A: Lending to individuals
Seasonally adjusted

		Total[a]				**Secured on dwellings**			
		Change	Growth rates Per cent			Change	Growth rates Per cent		
		£ billions	1m	3m(ann)	12m	£ billions	1m	3m(ann)	12m
		BZ2C	BZ2E	BZ2G	BZ2K	VTVJ	VTYF	VTYG	VTYI
2012	Sep	1.7	0.1	0.7	0.7	0.6	0.0	0.5	0.8
	Oct	0.1	0.0	0.5	0.6	0.4	0.0	0.3	0.7
	Nov	0.1	0.0	0.5	0.5	0.0	0.0	0.3	0.6
	Dec	1.7	0.1	0.5	0.7	1.0	0.1	0.4	0.6
		BZ2A				VTXK			
Amounts outstanding			1 421.8				1 265.1		

(Bank of England 2012)

The above table indicates a 0.7 per cent annual growth in unsecured consumer credit in December 2012. However, according to a recent report by PriceWaterhouseCoopers (PWC 2011), this upturn follows a three year downturn. In 2011, the consumer credit market contracted for a third successive year, with unsecured borrowing falling by 4 per cent.

Average household debt fell by about £355 over the period and now stands at around £7,900 in unsecured debt.

The PriceWaterhouseCoopers (2011) report illustrates how the UK credit market is changing. As banks and mainstream lenders make it more difficult for people to obtain unsecured personal loans, people are changing from bank loans and credit cards towards greater use of overdrafts (through the use of debit cards) and payday loans.

According to the PwC report the number of credit cards in circulation and total credit card borrowing both fell in 2011, whilst an increasing number of consumers, including more prosperous consumers, are seeking loans from alternative lenders. This has underpinned significant growth in areas such as payday lending and pawnbroking. Payday lending is fed also by an increasing number of younger people who prefer to use digital payments, such as through using their mobile phone.

Sub-prime credit cards and various kinds of sub-prime lending exploded prior to financial crisis, lenders all withdrew when wholesale market collapsed in 2007.

The large sub-prime lender, Welcome, collapsed following crisis and Provident folded their "me too" longer term / larger loan lending operation not long afterwards.

In relation to sub-prime credit cards, this has now effectively reduced to Vanquis which has grown to about 700K card holders since established. Capital One retreated up risk spectrum following OFT decision to cut penalty charges in half in 2012 on which business model depended. Now it has 80 per cent of sub-prime credit card business C2D but less high-risk and better off demographic than Vanquis. It has about two million customers

Q.3.2. Deprived consumers

High-cost credit has grown at rapid rates over the last few years with payday loans and pawnbroking being particularly dynamic segments. Lenders are criticised for charging high rates of interest to low-income consumers, but on the other hand, they offer credit to those who cannot obtain it from other sources and giving them an alternative to mainstream providers.

However it should be noted that low-income consumers often use mainstream credit card and overdrafts (see Ellison 2011). Ellison argues that currently the evidence is that the issue is not always the growth of sub-prime lending but the fact that so many people are trapped servicing mainstream revolving credit lines, including credit cards and overdrafts, which they took out in the pre-crisis years which they can service but cannot pay back.

The main forms of high-cost credit available to deprived consumers are:

Home credit

For home credit, the cost of credit is high and the same price applies to all borrowers, regardless of payment record. The cost of home credit, depending on the loan term, is currently circa £82 per £100 (for the 87 per cent of borrowers who do not refinance their loans) regardless of the number of missed payments.

Home credit, the traditional high-cost product, is now used by 2.4 million individuals, 2.2 million of whom are low-income users (i.e. 90 per cent of customers are in the lowest 50 per cent of household incomes), 14 per cent of the low-income population.

Some 39 per cent of home credit users are benefit dependent while only 3 per cent of payday loans users are, reflecting the requirement of these lenders that borrowers are banked and in work (Ellison et al 2011).

Provident and Greenwoods are two of the best known home credit companies with the largest home credit company accounting for 49 per cent of the home credit market. The home credit market has been valued at £2bn with 10 per cent of British consumers having used home credit at some point in their lives. (National Consumer Council Super complaint to the OFT on home credit, 2004).

Home credit companies typically provide small, short-term, unsecured loans. The website of Provident Personal Credit provides an illustrative cost of a loan of £500 repaid at £25 a week over 31 weeks. The total amount repaid is £775, at an APR of 365.1 per cent. The loan repayments are collected from people in their own homes.

The home credit companies have defended the high-cost of their business in relation to the high-cost of their convenient doorstep collection methods by a network of local agents and the extent of credit risk, as explained to the Office of Fair Trading:

> *"Home credit lenders told us that the price differential for home credit may be accounted for by factors such as the default risk, the nature of the product (unsecured, short-term with flexible payment), agent network costs and the lenders cost of capital." (OFT response to National Consumer Council Supercomplaint, 2004)*

Home credit has been flat for best part of decade or two. Its heyday was in the 1960s and 70s.

Payday loans

The cost of payday loans is typically £25 per £100 for online borrowing6 and £17 per £100 for store-based borrowing for the 70 per cent of payday borrowers who repay their loan to term.

For the 15 per cent of payday borrowers who refinance their loans and repay after 60 days (one roll-over), the cost rises to £34 per £100 on the store-based model and £50 per £100 on the online model. In the average case for all 29 per cent of payday borrowers who refinance their loans and repay their borrowing after 90 days (the average number of roll-overs being 2.1), the cost to the consumer rises to £51 per £100 on the store-based model and £75 per £100 on the online model.

Buyback Stores

Cash Generators and Cash Converters are two of the better known franchises operating a buyback service. Cash Converters was founded in Australia in 1984 and is the largest company with a network of 90 franchised stores in mainly low-income communities.

Both franchises offer new goods, pawnbroking and cheque cashing services, as well as a buyback facility. Short-term credit is in effect replaced by handing over ("selling") ownership

of a personal item. Commonly a loan of one third of the value of an item can be raised. The customer retains the right to buy back their item at a higher price within a 28 day period. The raising of short-term credit for a 28 day period is replaced with the selling and buying back of a personal item. As it is not legally considered to be a credit agreement, it is not subject to consumer credit legislation.

In 2000, a Citizens Advice report, entitled Daylight Robbery, highlighted a CAB in West Sussex that gave an example of a client who borrowed £150 by providing his stereo – valued at £500 – as security to a buyback store. The amount had to be repaid within 28 days with an interest charge of £42. This equates to an APR of 1,834 per cent.

Cheque cashers

The Loan Store, The Money Shop, BrightHouse and Cash Generator all provide a cheque cashing service. Short-term credit can be provided by cheque cashers in the form of a "payday advance".

The Money Shop provides a 30 day cash advance of up to £500 instantly. Receipt of the cash requires a consumer to write out cheques payable to The Money Shop for the amount of the advance. The cheques will not be presented to the bank for 30 days. Their promotional leaflet states that a "small commission fee" will be charged for this service. Cash Generator will provide a payday advance of up to £400 on personal cheques that will not be banked for 28 days. The British Cheque Cashing Association (BCCA) claims that the average fee charged by one of their members for cashing a cheque is around 10 per cent of the cheque's value.

Pawnbrokers

After a period of decline, pawnbrokers are making a return to the local high street. People pledge an item, usually jewellery, for a set period of 6 months, against a cash loan. The amount of the loan is decided on the condition and the value of the article and on the amount requested by the customer. It is usual for a loan of only one third or half the value of the item to be granted. Typically an interest rate of £5 per month is quoted, equivalent to an APR of 69 per cent over six months. The pledge can be extended for further periods by paying the interest due on the loan.

Telebanking

The Telebank catalogue offers household furniture, televisions and other home accessories. Telebank provides an option to pay for a purchased item through a meter attached to the TV. An administration fee of £20 is charged on all new accounts (usually in 4 instalments of £5). Payment by meter TV involves an "additional meter charge of £3.50" per month. All retail products are repayable over 36 months. The catalogue provides a "typical credit example" for a Montana two door wardrobe at a cash price of £200. 36 monthly payments of £8.94 means that the total amount payable is £321.84. However, if making repayments through a meter it is necessary to include 36 monthly repayments for the £3.50 per month meter charge, amounting to an extra £126 for the meter. The total cost for the £200 wardrobe, if paid for by a metered TV, is £447.84, however the APR is quoted as "APR 39.9 per cent variable".

Weekly repayment retail stores

Brighthouse is one example of rent-to-buy stores. It had sales of £193 million per annum, serving 175,000 customers out of 223 stores in 2010.rapid growth in stressed economic conditions. 21 new stores were opened in 2010

BrightHouse, sells retail goods such as televisions and lounge furniture on hire purchase, the cost of which can be repaid weekly in seemingly affordable sums. To qualify for credit, it is necessary to provide the names, addresses and home phone numbers of five friends or relatives, as well as provide proof of residency, proof of income, and two other forms of ID such as utility bills.

Its website presentation is as a company with a strong social mission providing "no strings credit". The annual percentage rate charged on goods is advertised as 29.9 per cent APR. The real cost of purchasing items from BrightHouse usually includes insurance cover and other charges. In addition, Jenny Rossiter from Church Action on Poverty reported on examples of items being sold at much higher rates than available in another high street shop such as Argos. For example: A New World gas cooker purchased over three years with service cover costs £934, compared to £330 at Argos. A JVC Hi Fi at Argos costs £279.99, whereas at BrightHouse it costs £386.86: £106 more expensive, even if paying cash.

BrightHouse's own promotional leaflet called "Buying made easy" provides a typical example of a washing machine at a cash price of £351.10. In making 156 weekly repayments of £3.24, a total amount of £505.44 is paid for the washing machine. Optional service cover is available at £1.75 per week, which means that the total cost of the washing machine, including service cover is £778.44. The cost of buying this washing machine on credit is £427.34 more expensive than the original cash price of £351.10: more than double the original cost.

Illegal lenders

Illegal lenders operate in an unregulated and informal environment. Knowledge of unauthorised lenders is most commonly passed on through social networks as the nature of their operations means that they do not advertise or promote their services. Unauthorised lenders can charge however much they choose for a loan as they are not regulated nor subject to any legal requirements. The higher interest lenders can also be known as loan sharks, and are reputed to use threatening and intimidating methods to recover unpaid loans. This survey report found strong evidence of unauthorised money lenders operating in a rural area of West Scotland which did not have any other local alternative lenders.

The illegal lending sector is used by 3 per cent of low-income households, some 0.3m, rising to 6 per cent in the most deprived communities. It is concentrated in those without access to legitimate credit. Recent growth in illegal lending is ascribed to shrinking supply of high-cost credit in deprived communities by 52 per cent of those aware of illegal lending in their community.

Overdrafts and mainstream credit cards

Ellison et (2011) argues that the major trend in credit provision to those on low incomes in recent years has been the expansion of access to mainstream overdrafts and revolving credit, now the leading sources of credit for even those on the lowest incomes. Overdrafts are used by 4.3m low-income borrowers as a credit facility with a further 1.2m becoming overdrawn in the course of their banking. Credit cards are used by 3.5m low-income borrowers. Benefit dependent households now represent 25 per cent of low-income credit card holders.

There is a high degree of cross over between mainstream and non-standard lending, with 53 per cent of non-standard lending users also using mainstream products.

The expansion of revolving and overdraft credit has meant that behavioural pricing is increasingly shaping the cost of credit for those on low incomes. It is important to distinguish between the price of credit (as measured by the APR) and the actual cost of credit to the consumer. On mainstream credit products, additional costs arise from penalty charges for missed payments or failed direct debits, over-limit fees on overdrafts, raising cash or extended minimum payments on credit cards. For subprime products such as payday and home credit, behavioural costs are driven by the refinancing of loans.

Problems affording essentials and balancing competing pressures on budgets are a day-to-day reality for three quarters (74 per cent) of those on low incomes, which are reflected in missed payments on credit and household bills. 58 per cent of low-income borrowers use overdrafts as a credit facility and 44 per cent of those using credit cards have missed payments. For those incurring charges, average number of overdraft fees is 6.2 per annum with average number of missed payments on credit cards 3.4 p.a. Ellison et al (2011) have shown that , two thirds (67 per cent) of low-income credit users, some 6.7m individuals, are subject to behaviour-driven charges on their mainstream credit use.

> *“On an annualised basis, 3.6m p.a., or 44 per cent of the 8.2m low-income borrowers in the market in a year pay credit related charges for missed payments or over-limit fees. We estimate behaviour driven charges paid by low-income credit users on mainstream credit to be £560m p.a. Behavioural charges for missed credit payments or over-limit fees on overdrafts, for those paying charges, average £154 per head p.a. (Ellison 2013)*
>
> *The cost of credit for non-standard lending products, which have a high upfront APR, are less driven by behavioural charges. Some 29 per cent of payday loans are refinanced, with those refinancing rolling over an average of 2 occasions. Some 15 per cent of home credit loans are refinanced and rolled over into a new loan before the end of the term.*
>
> *Under uneven payment conditions the cost of credit associated with low APR products can quickly approach or exceed that of high APR products. Critically, individuals can pay a high-cost for their credit while not being able to repay their debt (Ellison 2011).*

High-cost sub-prime credit cards

There are a number of companies that provide high-cost credit cards designed for low-income consumers.

One of the leaders in the field is the Vanquis credit card, operated by the Vanquis bank, a subsidiary of Provident Financial, the home credit company. According to its website

> *Vanquis Bank - helping people repair bad credit*

- *We help people who have been turned down for credit elsewhere.*
- *We provide a sensible way to stay in control of your money.*
- *We offer a responsible and reliable financial service.*
- *We are a UK based company.*
- *We are part of the Provident Financial Group which was founded more than 130 years ago*

Vanquis charges 39.9 per cent APR.

In relation to sub-prime credit cards, this has now effectively reduced to Vanquis which has grown to about 700K card holders since established. Capital One retreated up risk spectrum following OFT decision to cut penalty charges in half in 2012 on which business model depended. Now it has 80 per cent of sub-prime credit card business but less high-risk and better off demographic than Vanquis. It has about two million customers

Deprived consumers also have a number of alternative lower-cost credit options

The Social Fund - Crisis loans

Crisis Loans are repayable awards made by the Government to people in people in difficult circumstances. Although there are no qualifying benefit conditions, Crisis Loans are only available when a person has insufficient resources to prevent a serious risk to health or safety to themselves or their family. In 2011/12 over 2.1 million payments were made, worth over £133.3 million.

Until March 2013, there was a single national loans budget from which Budgeting Loan payments as well as Crisis Loan payments were made. However the Crisis Loan scheme ends in March 2013, as a result of Government cuts. It will be replaced by a scheme operated by local authorities on a reduced budget. How this will operate will depend on the resources and commitment of each local authority. But in principle the local authority scheme will continue to provide help in everyday emergencies with the following expenses:

- living expenses (including help for those claimants waiting for their first full payment of benefit in arrears)
- rent in advance to non-Local Authority landlords
- board and lodging and hostel charges
- travel expenses when stranded away from home
- certain fuel charges

Some credit unions are administering crisis loans on the behalf of local authorities, and charging interest at the standard rate. Traditionally crisis loans administered by the Government were interest free. In other cases local authorities are converting crisis loans into grants and not asking for repayment. A typical crisis loan would be between £50 to £100.

Credit Unions

A credit union is a financial co-operative owned and controlled by its members and regulated by the Financial Services Authority. A credit union can accept savings deposits, grant loans, receive state benefit payments and provide bill payment financial budgeting schemes.

The maximum cost of a credit union loan is capped by law within section 11(5) of the Credit Unions Act 1979 at no more than 2 per cent per month on the declining balance. This is equivalent to an APR of 26 per cent APR or £12 paid on a £100 loan paid weekly over a year. There is current consultation on raising the interest rate .

Credit unions have expanded significantly since 2006 through the operation of the Financial Inclusion Growth Fund. This fund provided capital to credit unions to on-lend in low-income communities and revenue to develop and strengthen services for low-income and deprived consumers. The UK Government continues to support the development of the credit union sector with The Credit Union Expansion Project. This has involved £36m of Government investment to expand services, particularly in low-income communities

Social lending by credit unions and CDFIs, despite the expansion of the sector stimulated by the DWP Growth Fund and increased – and subsidised – lending to those on very low incomes, is used by only 2 per cent of low-income households.

Community development finance institutions (and social firms)

Community Development Finance Institutions (CDFIs) lend money to businesses, social enterprises and individuals who struggle to get finance from high street banks and loan companies. They help deprived communities by offering loans and support at an affordable rate to people who cannot access credit elsewhere. CDFIs traditionally provide loans to people who face barriers to accessing finance. For example, they may lend to individuals with a poor credit history or little collateral.

CDFIs and Social Firms are lending institutions which have to raise capital from social investment or from banks. They charge APR rates from 25 per cent to over 100 per cent. Fair Finance in London, a social firm, charges 44 per cent APR.

Q.3.3. Existing credit available to / used by low-income people

This is covered elsewhere in the report (cf. above)

However, it is worth noting that the profile of users in the two largest sub-prime sectors, home credit and payday loans, is very different. Some 42 per cent of home credit users are benefit-dependent while only 3 per cent of payday loan users are, reflecting the requirement of payday lenders that borrowers are banked and in work.

Ellison et al (2011) noted that there is a high degree of crossover between mainstream and non-standard lending, with 58 per cent of non-standard lending users also using mainstream products.[4] Nonetheless, a significant minority of non-standard credit users are highly constrained in their credit options. Some 25 per cent of home credit users and 23 per cent of payday users have no other credit options.

Credit supply to low-income households has shrunk following the financial crisis, with refusals highest for those on the lowest incomes and non-standard borrowers. Some 1.1

million have needed to borrow and been unable to in the last two years. One in twenty (5 per cent) of those who have been refused credit have turned to illegal loan sharks.

Q.3.3.1 Identify the bad practices / toxic products

There is good evidence of toxic products in the UK sub-prime credit market and this has occasioned a significant debate in Government often pressurised by agencies and organisations concerned about the impact of the sub-prime sector on low-income households.

Citizens Advice, Church Action on Poverty, Debt on Your Doorstep and the Centre for Responsible Credit are regularly pointing out the toxicity of credit products. Here is an example from the Citizens Advice note to the Office of Fair Trading high-cost credit review

> *A Merseyside CAB saw a 24 year old man who had taken out a payday loan for £375 at cost of £75. He could not pay back full amount before the next month. When the CAB contacted the lender it became apparent that the terms of the advance were such that if the capital amount was not repaid each month the man was considered to have taken a fresh advance each month at cost of £75. It appeared that the loan had been revolved three times in this way. Citizens Advice 2009*

In relation to the CAPIC project the concern is the toxicity of the rent-to-own retail stores sector, which was described as "*morally bankrupt"* in the 2011 Barnardos report, "A vicious cycle" The heavy burden of credit on low income families"

> *"Three-year rental arrangement with a weekly payment store that cost £1,074 for a fridge freezer, compared with a High Street price for the same product of £430.*
>
> *A vicious cycle: The heavy burden of credit on low-income families" (Barnados 2011*

The following illustration notes the toxicity of a rent-to-own product compared with the exact same product supplied through a high street store

The cost of a BEKO WMB91442LW washing machine (Barnados 2011)

Brighthouse (rent-to-own)

- £490 cost price
- £215 interest (3 years)
- £382 service cover 3 years)
- £163 Damage liability cover

- **Total £1,250**

Comet typical (high street store)

- £340 cost price
- £130 service cover (3 years)
- **Total £470**

The same washing machine purchased through the UK CAPIC project from Co-operative electrical would be £198.99. To buy that over 3 years with a credit union loan would cost

£279.24 (£1.79 a week) but the credit union would not make sure a small loan over 3 years – if repaid over a year , it would cost **£224.12 (£4.31 a week) UK CAPIC COST**

The following are further examples of toxic products, noted by Citizens Advice and Which.

> *“Citizens Advice is urging the Office of Fair Trading (OFT) to use new powers to suspend immediately the licences of four payday lenders which it believes have been "causing significant distress" to customers.* Citizens Advice *refused to name the four payday loan firms involved, saying it did not want to affect any investigation, but it did state that two are household names. The problems uncovered by the charity include: firms charging excessive fees; continuing to take money when debts have been paid off; firms preventing customers from making repayments online or over the phone, then slapping them with a charge for late repayment. The charity also said that the firms had been harassing customers with repeated telephone calls, text messages and emails, as well as chasing people for debts on loans when the individual had not applied for a loan in the first place” (This is Money website[19])*

Research from Which? in November 2012[20] revealed that despite payday loans firms claiming that borrowers are generally satisfied with the service they receive half of borrowers cannot repay their loans and 70 per cent regret taking one out. The 2012 research found that

- *Half (48 per cent) of payday loan users have taken out credit that it turned out they couldn’t afford to repay.*
- *A third (29 per cent) of payday loan users have taken out credit that they knew they couldn’t repay.*
- *In the last 12 months, more than half (57 per cent) of people with payday loans have missed a payment and have incurred charges because of missed or bounced repayments (56 per cent).*
- *43 per cent of payday loan users say it’s too easy to get credit.*
- *Almost a third (31 per cent) were hassled by debt collection agencies in the past 12 months.*
- *One in five (20 per cent) have been hit with unexpected charges.*
- *Seven in 10 (69 per cent) payday loan users say they have regretted taking out a loan or other credit product in the last year.*
- *A quarter (27 per cent) of payday loan users have sought debt advice in the last 12 months compared to just 5 per cent of users of any credit product.*
- *People who use payday loans (15 per cent) are more likely to use advertising to help them choose a product than users of any credit product (5 per cent)*

In response to this research, Which? called for:

- *More robust affordability assessments that take into account the borrower’s income, expenditure and their ability to repay the debt.*
- *Affordability assessments to take place each time a borrower requests to roll over a loan or take out a new one.*
- *Lenders to be clear and upfront about all extra charges and display them clearly on their website alongside the application process.*

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[19] http://www.thisismoney.co.uk/money/cardsloans/article-2279151/Citizens-Advice-calls-OFT-shut-household-payday-lenders.html

[20] http://press.which.co.uk/whichstatements/half-of-people-taking-out-payday-loans-cannot-afford-to-pay-them-back/#.UVs-D2xwZjo

- *Lenders to do more to help customers in financial difficulty by freezing penalties and working out suitable repayment plans.*
- *All extra charges to be fair and reflect the true cost to the lender. Excessive charges must be stamped out*

Q.3.4. Credit and saving culture / practices / data

Access to credit is an essential aspect of life on a low income. For many it is the only way of managing the ups and downs of the household budget and of funding major purchases. Few people on a low income have access to sufficient savings in an emergency and, in times of need, they had little option but to borrow (cf. Ellison et al. 2011).

People use credit cards, banks and overdrafts, high-cost credit providers such as home credit, payday loan companies, money shops and pawn shops, store cards, catalogues, borrowing from family and friends and social fund crisis loans. The use of illegal lenders exists. People also borrow from the credit unions, CDFIs and Social Firms

People often people access credit from multiple sources and even credit union members can continue to borrow from high-cost and other providers. There is often too simultaneous use of sub-prime and mainstream borrowing, with people having perhaps an overdraft, a credit card debt and a payday loan.

Research has identified the factors that people on low incomes take into account when deciding to access credit. The primary factor is accessibility. It is which provider will grant a loan that matters the most. This is particularly the case when people were desperate for credit. Other factors that influence choice are the immediacy of access to a loan, the ease and flexibility of repayment, straightforward terms and conditions, convenience, and ease of application. The issue of ease of application features highly as people often find the completion of application forms difficult. The cost of the loan is important but much more important is the amount payable per week or month. Affordability is judged not by the overall cost of the loan but by the level of the weekly or monthly payment and its impact on the household budget.

People on low incomes need to borrow mostly to cope with unexpected expenditure and household goods.

People on low incomes stress how difficult it is to save on a low-income, when getting by each week often means having to rob Peter to pay Paul. It was not easy to save a large amount. Currently, research tells us that only one in five people living in low-income households are actively ‘saving-engaged’ (Ellison 2011), a reality that was reflected throughout low-income communities.

In research studies (Jones 2013), low-income consumers are often asked about what helps them to save. Of course having disposable income is mentioned as a major factor. In addition, people say that they are helped to save if they have access to a convenient and easy way to save, if they could save in small amounts, including in cash, and if they could save regularly, even if only a small amount. Many people say that they are helped to save if they were saving for a specific purpose, rather than just saving generally or for a rainy day.

Christmas savings schemes are very popular in low-income communities. These schemes give people a mechanism to save but which locks savings in until November. This is seen as important as it assures constant saving even when people are struggling with the household budget. For similar reasons, credit union members value the default saving mechanism through which people save automatically whilst repaying a loan. In most credit unions, savings accrued whilst borrowing were also subject to restricted access if they remain less than the value of the loan outstanding.

People save in credit unions, in the post office, in the bank, by buying savings stamps or just by keeping money in cash hidden at home.

Factors that hinder people from saving are the high-cost of living and the difficulties of making ends meet on insufficient income. Secondly, people identify that they lack a savings culture (Jones 2013). Saving is not part of their lifestyle nor is it especially encouraged and supported by family and friends. Other factors hindering saving include lack of access to a convenient savings facility and the perception that it would be difficult to open a savings account in a bank as people would not have the required ID or documentation.

Q.3.5. The impact of loan interest rate on credit supply in low-income communities.

The introduction of an interest rate cap on loans has been considered by the UK Government but as yet the imposition of a cap has not been seen to be in the long-term interest of low-income borrowers. Recent research carried out by Bristol University (noted in section 2.3.1. above) argued that there was a strong need to address the serious detriment to borrowers of the high cost of credit but also how lenders assess affordability, multiple and repeat borrowing and loan renewals. However, the research was inconclusive on the need to introduce a cap as this may result in negative consequences to borrowers. In response to the Bristol study, the Government confirmed that it would not introduce a cap on credit at this time, even though it might do so in the future.

There are strong proponents, however, for the introduction of an interest rate cap in the UK, including Stella Creasy, Labour MP for Walthamstow. The argument for an interest rate cap is to ensure that the high-cost credit providers do not impose extortionate and unreasonable changes on low-income consumers. The argument is powerful, given the fact of the high cost of credit often running into thousands of per cent APR.

However, the evidence suggests the introduction of a rate ceiling to the UK would also be likely to include the following effects: These points are based on research undertaken by Policis and Liverpool John Moores University (Ellison 2011)

- If a rate ceiling were to prohibit high APR products and result in the exit of high-cost lenders from the market some, largely the poorest and most vulnerable consumers, will lose access to credit that they need to make ends meet.
- Some of those who lose access to credit will be diverted to the black credit market, where costs and risks will be significantly higher and outcomes more damaging.

- Others with access to the credit mainstream will be diverted to products such as overdrafts and revolving credit that under uneven payment conditions may not be significantly lower cost and could be higher cost than high APR products.
- Some of those diverted to mainstream products will find it difficult to avoid escalating or unmanageable debt. There is a risk therefore of both increased indebtedness and increased financial distress arising from higher levels of delinquency and default.
- If a cap were to be structured so as to take in the total cost of credit including penalty charges and similar, more of those on low incomes are likely to find access to mainstream options restricted or curtailed altogether.
- The impact of a total cost of credit cap will likely be significantly greater than if the cap were restricted to APR while also increasing the potential for unintended effects. There is the potential for a very significant number of low-income consumers and a broad spectrum of mainstream credit products and lending models to be impacted, with serious implications for access to credit for low-income consumers and higher risk borrowers.
- Despite the significant advances in the sector, social lenders are not in a position to provide credit on anything approaching the scale that would be required to compensate for the loss of private sector lending to low-income borrowers currently using high-cost lenders, far less a wider spectrum of borrowers who might find their access to mainstream products restricted.

Q.3.6. Responsible credit practices illustration

This has been covered in other places in this case study – section 2.4.

Q.3.7. Research data on customer knowledge

The constant struggle to balance competing demands on tight budgets is key to the dynamics of credit use. Few of those on low incomes have savings safety nets and sums saved are insufficient to act as an alternative to borrowing. Lack of savings reflects a lack of available funds rather than any preference for borrowing

The struggle to make ends is a constant condition, especially for those with very low incomes. Just one in three (33 per cent) low-income households – four in ten (39 per cent) households with the lowest 20-50 per cent of incomes – are able to balance their income and outgoings comfortably. One in four (25 per cent), rising to one in three (33 per cent) households in the lowest income quintile, are struggling or falling behind on outgoings and commitments (Ellison et al 2011)

Affordability pressures are a day-to-day reality for most low-income households. Payment problems and difficulties in affording essentials are widespread among low-income households. Two thirds of low-income households struggle with at least one key category of

household expenditure, rising to three quarters (74 per cent) of those in the lowest income quintile.

Ellison et al have shown that one in ten low-income households and one in five (20 per cent) households in the lowest income quintile struggle to afford food for the family. A quarter (24 per cent) of low-income households, and a third (32 per cent) of those in the lowest income quintile, struggle to pay for gas and electricity, and similar proportions of both groups say they find it hard to afford clothing and shoes. One in five has difficulty paying for major essential household items (19 per cent) and almost as many (17 per cent) have difficulty covering the costs of repairing or replacing essential household equipment. Against this backdrop of financial hardship, one in four (24 per cent) struggle to afford to buy presents for Christmas and birthdays.

Late and missed payments on bills and utilities are a fact of life for a significant minority. Almost a third (31 per cent) are in arrears on household bills. One in four (24 per cent) low-income households, and one in three (34 per cent) of those in the lowest income quintile have current arrears. The most important functions of low-income borrowing are funding major purchases and bridging cash flow gaps one or more of their household bills at the time of the survey.

Finding even small amounts to cover unexpected expenses or emergencies causes significant difficulties. Overdraft finance, credit cards and mainstream personal loans are now the most important low-income credit sources. Long established sub-prime models remain significant while new sub-prime sectors are still small, albeit growing rapidly

Use of credit is driven by financial pressure, availability of savings and ability to bridge a cash emergency

Low-income consumers make their decisions about the use of credit and their choices of credit product in the context of constrained incomes, competing pressures on budgets and varying degrees of choice of credit options. The decision to use credit is, to a large extent, a function of whether individuals have any form of savings, the extent of financial pressure they are under and whether they would be able to bridge a cash flow emergency or cope with peaks of expenditure without borrowing.

Ellison et al (2011) confirmed that access, convenience and the flexibility and manageability of repayments can be as important as price. Often the high-cost credit options are valued even though they are costly. For example, home credit users often take the view that, despite its high-cost, home credit plays a positive role in the management of household finance. More payday borrowers feel that payday can be cheaper and less high risk than mainstream credit than feel that mainstream products are a better solution. Balance of costs and risks on overdraft finance versus payday borrowing finely balance but more emphatic view that payday less high risk than revolving credit. Research indicates, despite the toxicity of the product, far more Payday borrowers take the view that payday has a positive impact on their ability to manage their finances than take the opposite view/

Q.3.8. Final conclusions,

Key conclusions from the case study

Cost of credit is only one of the consumer protection issues – risks to financial well-being and security are equally important

- The expansion of access to affordable in low-income communities through credit unions and other social lenders is a key policy issue and offers the greatest opportunity in the fight against extortionate credit in low-income communities.
- Regulatory and consumer protection regimes need to be based on an in-depth understanding of the reality of consumer dynamics, particularly for low-income credit users.
- Policy approaches to regulation of the low-income credit market need to take into account the widespread use of credit use, including overlapping use of mainstream and nonmainstream options, and they need to focus on making credit markets work for low-income consumers, while minimising the potential for harm/
- The majority of low-income credit users benefit from access to mainstream credit use but it is important to recognise that mainstream products can be both high-cost and high-risk for a significant minority of low-income consumers.
- A market that features a multiplicity of high and low APR product options allows low-income consumers to choose the products that best suit their circumstances and the risks they face. Even though there is a danger of detriment, the existence of the sub-prime market does support low-income families. This market requires greater regulation and control rather than its being forced out of existence. This regulation has been noted by Which? (see section 3.3.1):
    - *More robust affordability assessments that take into account the borrower's income, expenditure and their ability to repay the debt.*
    - *Affordability assessments to take place each time a borrower requests to roll over a loan or take out a new one.*
    - *Lenders to be clear and upfront about all extra charges and display them clearly on their website alongside the application process.*
    - *Lenders to do more to help customers in financial difficulty by freezing penalties and working out suitable repayment plans.*
    - *All extra charges to be fair and reflect the true cost to the lender. Excessive charges must be stamped out*
- The introduction of an interest rate cap on loans in the UK needs to ensure that the most vulnerable consumers do not lose access to the credit that they need to make ends meet.

Q.4. Other external relevant elements

The most significant issue for the CAPIC project in the UK is compliance of credit unions with the consumer credit act for debtor-creditor-supplier relationships.

Q.5. CAPIC and its integration in the local environment

In the UK, many financially-excluded people in low-income communities, when faced with the need to purchase a washing machine, television or other household electrical item have little option but to borrow money from sub-prime lenders, often at interest rates reaching 300 per cent APR; to use expensive weekly-pay catalogues; or to purchase from weekly repayment high-street rental purchase stores, where an electrical item can often cost more than three times the normal high-street price. Costs in these stores escalate with the addition of expensive additional service and insurance charges, which are made compulsory for customers with no home contents insurance.

In the 2007 EU report, Financial services provision and prevention of financial exclusion', written by University of Bristol for the European Commission, the authors highlighted the prevalence of these high-cost options in low-income communities and demonstrated poor low-income families end up been grossly overcharged for electrical and other household goods.

In this UK CAPIC partnership project in Nottingham, three organisations have come together in order to create an affordable option for people on low incomes who wish or need to purchase household electrical appliances. The project will enable people to purchase high-quality, affordable appliances with the support of a credit union loan. These appliances will be supplied by Co-operative Electrical and the project supported and promoted by the City Council as part of its financial inclusion strategy for the City.

A national programme

However, the UK CAPIC partnership in Nottingham is but one example of 160 partnership projects throughout the UK. Credit unions in around 160 locations throughout the country are working with The Co-operative Electrical to enable people to obtain affordable credit for the purchase of consumer electrical goods.

The partnership projects, apart from working with local authorities, all work closely with social housing providers to enable their tenants access affordable consumer goods. In fact partnership working with the social housing sector is key to the success of the project. Being able to directly target social housing tenants, around 70 per cent of whom experience financial exclusion enables credit unions to reach out to large numbers for financially excluded people.

Q.5.1. Who knows about the national CAPIC project?

The national UK CAPIC project, as partnership working between credit unions and Co-operative Electrical, and supported by local authorities and social housing providers, is known throughout the credit union sector. It has featured in national publications and been discussed at national credit union conferences.

The project is also advertised on many credit union websites. For example

http://www.wccu.co.uk/wccunew/coopelec.htm

and also here

http://www.princebishopscommunitybank.org.uk/Coop-Electrical

The CAPIC project is also promoted widely by The Co-operative Group.

http://www.co-operative.coop/corporate/Press/Press-releases/n/The-Co-operative-Electrical-and-Credit-Unions-tackle-financial-exclusion/

The participation of the credit union / Co-operative Electrical partnership in the EU funded CAPIC project has been promoted widely through the credit union and social housing sector. This was reflected in the participation in the CAPIC seminar held in Liverpool in October 2012. The project has also been communicated to the Office of Fair Trading, a speaker from which attended the Liverpool seminar.

Q.5.2. Who asks for credit through the CAPIC project?

The CAPIC project serves low-income and financially excluded individuals who need to purchase household electrical goods on credit. Many are tenants in social housing accessed through the intermediary of social housing providers.

Many of these borrowers would have otherwise gone to a weekly-payment, rent-to-own (hire purchase) store which offers goods on an affordable weekly payment basis. These stores target the sub-prime market and those on low incomes who cannot get credit elsewhere. They are attractive high street stores which offer goods a relatively reasonable rate of interest 29.8 per cent APR (sometimes up to 49.9 per cent APR). In any move to cap the cost of credit in the UK, these stores would not be captured. There rate of interest is comparable to that of a credit union and cheaper than a community development finance initiative (Fair Finance in London charges 44 per cent APR (in 2011).

The business model of these stores depends on offering goods at a high basic cost plus then convincing vulnerable consumers to take out optional service cover, damage liability cover. They also charge late payment “penalty charges” for default of £2.70 weekly per agreement). They refuse part-payments and if miss require following paying too.

A typical calculation is based on a Brighthouse advertisement (rent-to-own), quoted in Barnados (2012)

- £490 cost price for a washing machine
- £215 interest (3 years)
- £382 service cover 3 years)
- £163 Damage liability cover

• Total £1,250 (over 3 years that is £7.53 a week which is then presented as affordable)

The same washing machine from Co-operative electrical is £198.99 and to buy that over 3 years with a credit union loan would cost £279.24 (£1.79 a week). However, the credit union would not make sure a small loan over 3 year. If repaid over a year, it would cost £224.12 (£4.31 a week)

By obtaining the washing machine from the CAPIC project, the borrower saves over £1,000.

Q.5.3. The UK CAPIC project and its relation to other financial inclusion initiatives

Credit unions are involved in a range of financial inclusion initiatives – on access to banking, savings and credit as well as to money and debt advice.

The CAPIC project is but an extension of the work of credit unions in low-income communities.

However, it also forms part of the financial inclusion strategies of social housing providers and local authorities – it is seen as an important element in combatting high-cost credit.

Q.5.4. Access to the UK CAPIC project through integration with local workers

This is mainly through partnership working with social housing providers, money and debt advice agencies and local authorities.

The link with the social housing sector is the most important.

Q.5.5. Analysis of demand and the promotion of the UK project

Analysis of demand was not scientific, but arose out of the experience of credit union workers meeting people in the local community who were using high-cost , rent to own stores. These stores are highly visible in most low-income areas of the UK. The CAPIC project was created as a response to this perceived need.

Only about 2,000 loans have been made through the CAPIC project. This is low and does not reflect potential demand. It is a product of the delay the project has experienced through its realisation that it needs to comply with the consumer credit act for debtor-creditor-supplier relationships. This was a hotly contested issue in the credit union movement and necessitated legal advice and negotiations with the OFT. This delayed development.

Out of the CAPIC project has come another small developmental project , funded by the Co-operative Enterprise Hub, to work with a CAPIC participating credit union to ensure all systems and procedures are compliant with consumer credit legislation. This will involve a rewrite of loan agreements, loan pre-contractual and post-contractual literature. It is a significant learning curve for credit unions which have been exempt from the consumer credit legislation. A major re-launch of the project is planned when this work is completed.

Normally however, the project is promoted through literature available in credit unions and in social housing offices, and on respective websites

One credit union operating the CAPIC project, Prince Bishops Community Bank, has opened a high street store to compete directly with the high-cost rent to own stores. Set up in partnership with the Prince Bishops Community Bank and Social Housing Enterprise Durham (SHED), the aim of The Store is to steer people away from loan sharks and other high-cost borrowing options. Customers pay for their items weekly, with a proportion of each payment being deposited into a credit union account, encouraging regular saving

Q.5.6. Reaching out to the most vulnerable population

This is mainly done through links with social housing providers and through the general credit union membership.

Credit unions through the support of the Financial Inclusion Growth Fund made major inroads in to the most vulnerable population. The CAPIC project offers people yet another option.

Q.5.7. Social audit analysis of UK CAPIC project impact

This has not yet been undertaken by the CAPIC project

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