

## Use your vote on Thursday to help low income households escape the debt trap

Dear MP,

According to last year's Office of Fair Trading review, high cost lenders, including pawnbrokers, payday lenders, rent to own stores, and door to door collected moneylenders advanced £7.5 billion of loans in 2008.

However, this often comes with devastating impacts for borrowers, with a host of research conducted over the past twenty years indicating that low income households, and particularly those with children, are often forced to cut back their spending on food, fuel, and other essentials in order to make the repayments. The results include rent and council tax arrears, poorer diets, cold homes, and physical and mental health problems. These problems also contribute to making a return to work more difficult - creating a 'debt trap' and leading to an ever increasing dependence on high cost credit just to make ends meet.

High cost credit affects us all - degenerating local communities and increasing the pressure on public services at significant cost to the taxpayer.

On Thursday you can signal to Government that it is time to take effective action to address this problem. A motion from Stella Creasy MP and Justin Tomlinson MP will be moved in the Commons calling for Government to give regulators the power to cap the total cost for credit.

The motion is based on Stella Creasy's Consumer Credit (Regulation and Advice) Bill which proceeds to a second reading on the following day. This includes important safeguards to ensure that ceilings are set at an appropriate level and do not restrict access to affordable and responsible credit. In particular, regulators must be satisfied that there is a lack of effective price competition which is causing consumer detriment, or that charges are so high that they clearly indicate lenders are taking excessive risks, before imposing a cap.

Research published last week by the European Commission supports this approach. The research comprised a review of existing studies, including one commissioned by the then Department of Trade & Industry in 2004, and looked at the effects of ceilings in the fourteen European countries that already have these in place.

It finds that concerns that ceilings would reduce access to credit have been primarily based on US studies, where ceilings had been introduced at very low levels (around 12%). Generalising the effects of ceilings from these very tight caps is therefore misleading. Higher ceilings can be used to ensure that people who represent a reasonable credit risk continue to have access, whilst they also protect people who would otherwise become over-indebted from being offered loans which they clearly can't afford to pay back.

Our own research on payday lending shows that in Canada, where sensible ceilings have been imposed on the payday lending industry, lenders such as Dollar Financial, which owns the Moneyshop brand in the UK, have actually welcomed ceilings because they are used to eliminate only the very worst operators from the market.

The European research also debunks a number of other myths, finding that there is 'no convincing' evidence to support the argument, on which the industry has heavily relied, that introducing ceilings leads to a growth in illegal lending or would force people to default on bill repayments. In fact, when the researchers asked industry, consumer and regulatory stakeholders across Europe for their views on the extent of illegal lending in their countries, it was those countries without ceilings in place which reported the worst problems.

In addition, it refutes the argument that ceilings can always be avoided by lenders - for example by increasing other charges which are not subject to the cap - noting that the way the ceiling is formulated is critical, and that many of the problems previously attributed to ceilings are the result of these being based on the APR%. Different ceilings for different parts of the credit market, as suggested by the Consumer Credit (Regulation and Advice) Bill would also be required.

Of course, ceilings are not the whole answer, although they would address the worst problems in the market pending other measures taking effect. These additional measures need to include a huge expansion of more affordable credit to increase competition and provide low income households with a real alternative. As yet Government has not released any plans which would achieve the level of expansion required. Credit Union lending in 2010 was only £420 million - a vast improvement on previous years, but nevertheless less tiny in comparison with the size of the high cost credit sector. Much of that recent expansion was also due to direct Government support, which is currently under threat.

We are aware that the credit industry is lobbying against the use of caps on the total charge for credit. They have previously cited the Office of Fair Trading's argument that educating consumers to drive an increase in competition is what is required in the long term. This is put forward on the basis that consumers using high cost credit are not price sensitive.

In reality this is a 'do nothing' option which completely fails consumers, and we ask you to reject it for three reasons:

- There is no evidence that improving levels of information will result in greater price sensitivity amongst low income borrowers. Research indicates that they know the costs involved but are taken advantage of because they are often faced with financial crises and need to access credit quickly. In a consumer survey conducted by the OFT, the speed at which credit could be provided was the top consideration for users of high cost credit - a higher priority than either the cost of credit or the level of repayments. This position will not change unless income levels are increased.
- Despite trying a number of 'remedies' along the lines suggested by the OFT, the position in the home credit market is getting worse, not better. In 2006, when the Competition Commission found a lack of price competition in the door to door moneylending market, its largest lender, Provident Financial was charging £65 for every £100 it lent. Some four years later two of its main competitors have stopped trading, and it is now charging £82 for every £100 lent.
- The Consumer Financial Education Body itself recognises that the limits to financial capability as the means to address market failure. In a recent submission to BIS (p.6) it states clearly that "Our view is that there are occasions, particularly in uncompetitive markets, where to prevent consumer exploitation there should be caps on the total costs of borrowing."

Further support for the use of ceilings is also provided in the FSA's consultation document on product regulation in the mortgage market, which was issued last week. Although the FSA recognises that caps require difficult judgments about the level of the ceiling it notes (p.55) that:

"Even so, price capping may be a means of tackling the most serious cases of mass consumer detriment, where firms are making excess profits by exploiting a lack of consumer sensitivity to, or awareness of, prices."

The motion on Thursday is not concerned with the mortgage market. However, the conditions identified by the FSA of a lack of price sensitivity, excess profits, and mass consumer detriment are clearly apparent in the high cost credit sector. Ceilings therefore have a role to play in addressing them. What we now need is a sensible debate as to how to make them work, which learns the lessons from European experience, and ensures ceilings are set at an appropriate level and in a sensible form. We hope that you will support the motion on the 3rd February to ensure a serious dialogue with Government on these issues now takes place.