

Executive Summary

1. The past twenty-five years have seen dramatic developments in the use of consumer credit in the United Kingdom. These developments have contributed much to the improvements in the standard of living experienced by most consumers. The downside has been the increase in the number of consumers experiencing repayment difficulties seeking advice from CABx.
2. The dynamic changes in the consumer credit sector have not been matched by changes in the legislation intended to protect consumers from abuse. Problems of extortionate credit persist. The CAB Service has not been alone in arguing for some time that several areas of the Consumer Credit Act 1974 are in urgent need of reform. Indeed, the 1999 Consumer White Paper confirmed the Government's intention to assess whether changes are needed to the extortionate credit provisions of the Act.
3. Extortionate credit arises from either unduly high interest rates or from loans that put the borrower at a significant and unfair disadvantage against the lender. The report provides evidence of cases from all over England and Wales where extortionate credit agreements are enabling some creditors to take advantage of uninformed consumers.
4. CAB evidence shows that extortionate credit agreements exist across a range of credit products and agreements. There is a disproportionately large body of evidence associated with secured lending (particularly debt consolidation loans), lending to low income groups, lending attached to the sale of cars and home improvements, and lending attached to those with impaired credit records.
5. This report argues that the existing legislation on extortionate credit is neither effective nor accessible to consumers. The current 'test' that determines whether a credit agreement is extortionate is heavily weighted in favour of lenders. Moreover, the test can only be invoked if a borrower is prepared to risk heavy legal costs in taking the initiative and making an application to the court.
6. The view of the CAB Service is that the solution to the problem of extortionate credit lies in effective legislation that is accessible to the consumer and improving the ability of consumers to make more informed choices from a range of credit options.
7. The key changes recommended by the CAB Service include:
 - an amendment to the extortionate credit 'test' in simplified legislation;
 - the extension of the extortionate credit legislation to allow the courts to consider whether an agreement is extortionate without the need for an application from a borrower;

- a new power for specified third party agencies to take action on behalf of consumers;
 - significant improvements in the information provided to consumers on entering into a credit agreement;
 - requirement on some lenders to ensure that loans best meet the needs of the borrower and that the repayments are affordable;
 - a range of changes to the Consumer Credit Act 1974, relevant court procedures and forms designed to enable consumers to obtain reviews of their credit agreements under the extortionate credit legislation more easily.
8. The report also discusses two other possible changes in legislation. We consider how an amendment to the Unfair Terms in Consumer Contracts Regulations could complement changes to the extortionate credit provisions, We also examine whether a ceiling rate of interest would be of benefit, but conclude it would not be the best way of dealing with the problem.
9. The report concludes with a brief examination of the need to provide a wider range of borrowing facilities to low income groups and the role of improved financial literacy in tackling extortionate credit.
10. A full list of all recommendations can be found in Section 6.

1. Introduction

- 1.1 The past twenty-one years have seen a revolution in the consumer credit industry. In 1979, consumers could choose from just a few credit cards. By March 2000, this number had increased to around 1,300¹. In 1979 the choice of unsecured lending was limited to the major high street banks. By 2000 this had widened to include building societies, finance companies, overseas based financial institutions and even supermarkets. In 1979 bank customers wanting to arrange a loan had to ensure that they were able to visit their branch office on a weekday between 9.30 a.m. and 3.30 p.m. Today the proliferation of telephone and Internet banking provides 24-hour access 365 days a year. An ever increasing number of companies have entered the personal finance market offering an ever more bewildering choice of products.
- 1.2 For the majority of consumers, the opportunities that have come from this revolution have been largely positive. A substantial proportion of consumers have used credit to enable them to buy washing machines, computers, digital television, foreign holidays, and new or second-hand cars. In many cases, the credit would just not have been accessible to the individuals concerned without the changes in the consumer credit market. It is indisputable that living standards in general have been enhanced by the increased availability of consumer credit.
- 1.3 There is a downside to the increased use of credit. Previous CAB reports² have pointed to the personal and social cost of debt and poverty. House repossessions, court judgements and increased family pressures exacerbated by financial difficulty are just some of the issues dealt with on a daily basis by the typical Citizens Advice Bureau (CAB). Overindebtedness is a persistent and possibly growing feature of the consumer sector of the United Kingdom.
- 1.4 The rapid developments in the consumer credit sector have brought many challenges for both the credit industry and consumers. Ideally, these challenges would have been met by what the Government has recently described as a 'virtuous circle between well-informed, confident consumers and strong, competitive businesses'³. However, the reality is somewhat different.
- 1.5 The CAB Service's evidence from advising on over half a million consumer debt problems every year is that too many consumers are neither well informed nor confident when it comes to credit and debt. This report uses examples from that evidence to illustrate how, despite legislation intended to prevent extortionate credit, borrowers are entering into credit agreements that are unfairly weighted in favour of the creditor. There is a pressing need for more effective regulations to

¹ Credit Card Research Group

² The Cost of Living (1992), Dispossessed (1993), A Balancing Act (1999)

³ Modern markets; Confident Consumers – Implementation Plan for the Consumer White Paper (December 1999)

protect consumers from the excesses of credit companies that are not only strong and competitive but are also prepared to take undue advantage of vulnerable and ill informed consumers.

- 1.6 Unfortunately, the protection offered by the law regulating consumer credit has not changed to reflect the dynamic changes of the last quarter of the 20th Century. The primary legislation which regulates the credit industry continues to be the Consumer Credit Act 1974. The CAB Service has argued for some time that several areas of this Act need urgent reform if consumers are to be effectively protected. For example the consumer credit licensing regime is not effective in preventing unfair trading practices. The growth of cross border and Internet trading is leading to practical issues that were just not contemplated when the Act was first introduced.
- 1.7 The CAB Service welcomes the Government's intention to review the Consumer Credit Act. This report is intended to provide a contribution to the review. Although the Government's review needs to be wide ranging, in this report we want to concentrate primarily on the extortionate credit provisions of the Consumer Credit Act 1974. We explain how the current legislation is totally inadequate to safeguard consumers in the credit driven economy of the new millennium and propose changes.
- 1.8 The evidence cited in this report is only a selection of cases notified by over 100 CABx in England and Wales during the period April 1999 to July 2000.
- 1.9 The report is divided into two parts. Part one explains the problem of extortionate credit. Section one overviews the growth in consumer credit during the period 1979 – 2000. In section two we show how existing legislation purports to protect consumers against extortionate credit agreements and explain the concern that has been voiced from many quarters as to the failings of that legislation. Section three sets down the recent evidence of the CAB Service on the characteristics of extortionate credit as we see it existing in the UK at present.
- 1.10 Part two of the report identifies solutions to the problem of extortionate credit. Section four identifies different options for changes in legislation with our recommendations as to the changes that would be most appropriate to address the evidence of CAB. Section five explains the other measures and changes we consider necessary if consumers are indeed to become confident and well informed participants in the consumer credit market.

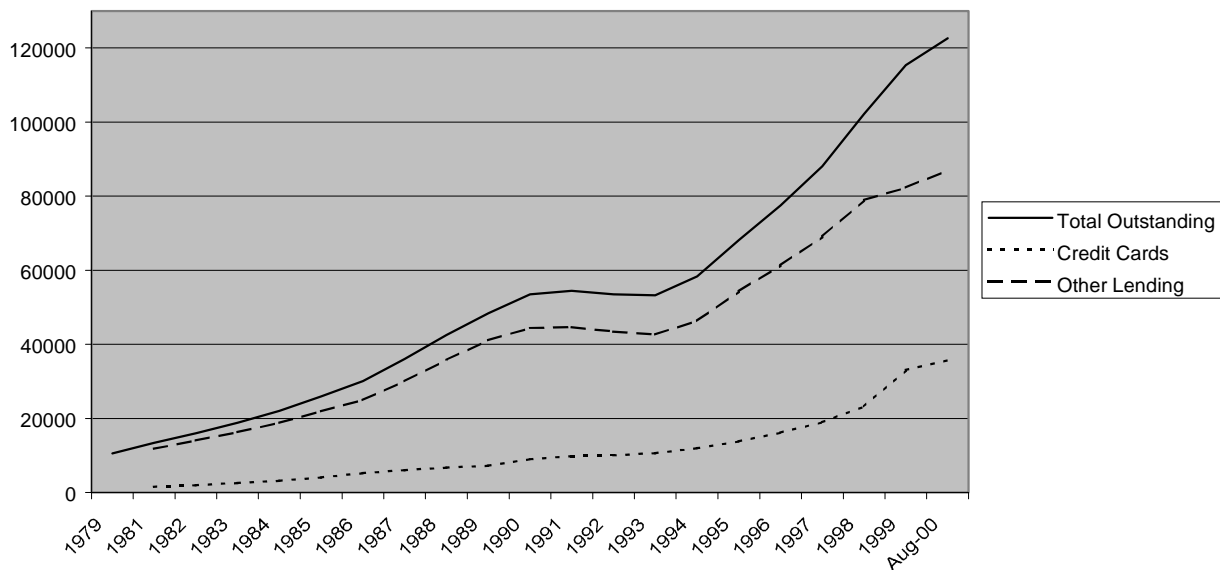
Part One: The problem of extortionate credit

2. Growth in consumer credit and the existing extortionate credit legislation

Growth in consumer credit

2.1 The amount of outstanding unsecured consumer credit in the UK economy has increased elevenfold since 1979 (see Figure One). As of August 2000, the amount of unsecured borrowing to be repaid stood at £122 billion, equivalent to £3,425 for every adult between the ages of 18 and 65. If only half of that group actually has outstanding borrowing the average indebtedness increases to £6,850 per person or £13,700 per two adult household. However, CABx are currently advising individual clients with unsecured debts far in excess of this 'average' figure, and NACAB regularly receives reports of household unsecured debt well in excess of £20,000.

Figure One: Outstanding Consumer Credit £million



Source Table 3.2B 'Financial Statistics' - National Statistics (October 2000)

2.2 Enquiries to CABx on credit and debt have also shown a similar dramatic increase over the past twenty years. In 1980 the Annual Report of the CAB Service made no mention of debt. Any debt enquiries that were made were recorded within the category of 'consumer, trade, and business'. In 1999/2000, the CAB Service answered over 698,000 enquiries on consumer debt and credit. Enquiries on consumer debt have increased by 46% since 1996/97 and now make up nearly ten percent of all enquiries⁴.

⁴ The total number of enquiries answered by CABx in 1999/2000 was 6,106,959

- 2.3 The growth in consumer credit since 1979 has taken place alongside Government policy of financial deregulation⁵ combined with the ever-increasing willingness of consumers to take on credit agreements. The willingness of UK consumers to buy now and pay later together with the existence of only a basic regulatory framework to control consumer credit means that British consumers are widely regarded as being at the top of the European league table in their use of credit.
- 2.4 Projecting ahead, most commentators agree that this trend will continue. The amount of outstanding consumer credit continues to reach new heights almost every month. Spending on credit cards is showing a particularly high year on year increase. The most recent, September 2000, figure is over 20% higher than that for the same period twelve months earlier⁶. Finance companies continue to devise new products and promote them with ever more sophisticated marketing and advertising techniques. Overindebtedness is rapidly rising up the political agenda both in the UK and in other European countries.
- 2.5 The growth in consumer credit has highlighted the issue of market regulation. Partly this has been concerned with the macroeconomic effect of a growing volume of consumer credit. The CAB Service is concerned about the impact of credit growth and the need to protect consumers from abuse in a market of ever increasing complexity.

Legislation to regulate extortionate credit

- 2.6 Recent legislation on extortionate credit dates back to the Moneylenders Act of 1927. This provided an interest rate 'ceiling' of 48% and a presumption that any rate above this level was excessive and the credit transaction harsh and unconscionable.
- 2.7 In 1968 the Government established the Crowther Committee to investigate all aspects of credit granting. The subsequent report of the Committee was instrumental in framing the Consumer Credit Act 1974. One of the areas revised in the new Act was that of extortionate credit. The Crowther Committee justified the need for such revision on the grounds that the existing legislation had been 'largely ineffective'.
- 2.8 Sections 137 to 139 of the Consumer Credit Act 1974 sets down the legislation that protects against extortionate credit. Section 137 allows the court to reopen an extortionate credit bargain "so as to justice between the parties". However, section 139 makes it clear that the court can only investigate an agreement at the specific application of the borrower or surety. Section 138 is the core section that sets down

⁵ 1979 - controls on transaction in foreign exchange abolished; 1980 - 'corset' on bank lending abolished; 1981 - Reserve Asset ratio abolished; 1982 - Hire Purchase controls abolished; 1986 Building Societies Act

⁶ Credit Card Research Group

the criteria by which a credit agreement may be considered extortionate:

'138 (1) A credit bargain is extortionate if it:

- (a) requires the debtor or a relative of his to make payments (whether unconditionally, or on certain contingencies) which are grossly exorbitant, or*
- (b) otherwise grossly contravenes ordinary principles of fair dealing.*

(2) In determining whether a credit bargain is extortionate, regard shall be had to such evidence as is adduced concerning –

- (a) interest rates prevailing at the time it was made,*
- (b) the factors mentioned in subsections (3) to (5), and*
- (c) any other relevant considerations.*

(3) Factors applicable under subsection (2) in relation to the debtor include –

- (a) his age, experience, business capacity, and state of health; and*
- (b) the degree to which, at the time of making the credit bargain, he was under financial pressure, and the nature of that pressure.*

(4) factors applicable under subsection (2) in relation to the creditor include –

- (a) the degree of risk accepted by him, having regard to the value of any security provided;*
- (b) his relationship to the debtor; and*
- (c) whether or not a colourable cash price was quoted for any goods or services included in the credit bargain.*

(5) Factors applicable under subsection (2) in relation to a linked transaction include the question how far the transaction was reasonably required for the protection of debtor or creditor, or was in the interest of the debtor.'

2.9 The intentions of the legislation are commendable. The courts are given wide discretion to investigate the circumstances surrounding an individual credit agreement. Guidance is given as to factors that the court should take in to account, such as interest rates, and 'any other relevant consideration' can also be examined. There is therefore the opportunity for an aggrieved borrower to alert the court to any particular issue that may be relevant in an individual case. The fact that section 138 (1) (b) deals with 'fair dealing' between the parties allows the court to look behind the credit agreement and take account of any sharp practices. If a court decides that an agreement is extortionate there is wide power for the court to re-write the credit agreement so as to ensure fairness between the parties.

2.10 In theory, the 1974 Act offers consumers protection from extortionate credit. But, regrettably, the intentions behind the legislation have not been translated into practice effectively. Extortionate credit bargains persist and successive Governments have acknowledged the problems that exist.

- 2.11 Government concerns about the effectiveness of the extortionate credit legislation first came to light in the 1988 White paper on 'Promoting Enterprise'. In November 1990 the Government asked the Office of Fair Trading to undertake a review of the provisions of the extortionate credit legislation and to report on what, if any, reforms were needed.
- 2.12 In 1991, The Office of Fair Trading (OFT) reported on its detailed investigation into extortionate credit. The report was highly critical of the working of the legislation. The Director General stated, "The extortionate credit provisions of the Act have not effectively dealt with the problems to which they were addressed." The main proposal from the OFT was a new concept of an 'unjust credit transaction' to replace that of an 'extortionate credit bargain'. Further, in determining whether an agreement was unjust, the OFT proposed that the court "should consider whether a transaction involved excessive – not grossly exorbitant – payments". Other recommendations included that the court should be empowered to re-open a credit transaction of its own initiative and that tougher penalties should be introduced for the unlicensed provision of credit.
- 2.13 The report from the OFT was welcomed by the then Secretary of State for Trade and Industry. In December 1991 he informed Parliament of his conclusion 'that the present provisions of the Act are inadequate. Amending legislation is necessary and should be introduced when parliamentary time permits making a number of important changes to sections 137 to 140 of the Act, broadly on the lines recommended in the Director General's report'⁷. No action was subsequently taken to introduce the necessary changes.
- 2.14 Eight years later in 1998 the Department of Trade and Industry (DTI) commissioned independent research from the Personal Finance Research Centre at the University of Bristol. The aim of this study was to examine "whether extortionate credit is a significant problem for consumers in the UK, who are the consumers most vulnerable to it, and what steps could be taken to improve consumer protection in this area".
- 2.15 In July 1999, the Consumer White Paper 'Modern Markets:Confident Consumers' committed the Government to 'looking at the rules on extortionate credit to examine the extent to which this is a problem for consumers'. The White Paper confirmed this would be achieved through the academic research already commissioned by the DTI and the subsequent implementation plan for the White Paper added a further commitment to 'publish proposals' by a target date of 'Spring 2000'.

⁷ Hansard, 12 December 1991

- 2.16 The research from the Personal Finance Research Centre was presented to the DTI in June 1999⁸. Almost inevitably given the lack of action in the intervening years, the report came to very similar conclusions to that of the OFT eight years earlier. *'On the whole, the Consumer Credit Act 1974 has proved inadequate to deal with many of the current extortionate practices The wording of the Act is too imprecise and the judicial decisions have been based on a restrictive interpretation of its provision ... there are inadequacies at all levels of the enforcement process Borrowers are reluctant to co-operate with legal proceedings ... the market for extortionate credit is encouraged by the paucity of consumer information'*.
- 2.17 The Personal Finance Research Centre report made eighteen recommendations on improving consumer protection for vulnerable consumers. It is regrettable that, as at November 2000, the DTI has only consulted publicly about proposals to take forward just one of the eighteen recommendations; that judges should be allowed to re-open cases without an application from the borrower.
- 2.18 It is difficult to understand how there can be such a consensus of opinion for nearly a decade that legislation is not working properly, with proposals for remedies, yet no progress towards improving the situation.
- 2.19 There is a case for many of the recommendations in the report from the Personal Finance Research Centre to be pursued by Government. The findings and recommendations from that report should be further discussed within Government, with consumers, the credit industry, and other interested bodies.
- 2.20 **The CAB Service recommends that the Department of Trade and Industry seek views from interested parties, industry and consumers on all of the recommendations of the Personal Finance Research Centre. Following consultation the Government should act to implement changes to the legislation without delay.**

⁸ Extortionate credit in the UK: A report to the Department of Trade and Industry
Elaine Kempson and Claire Whyley June 1999

3. CAB evidence on the characteristics of extortionate credit

- 3.1 Extortionate credit is often discussed as being primarily, and perhaps even exclusively, evidenced by excessively high interest rates. Certainly most enquiries CABx receive about extortionate credit agreements focus on the interest rate aspect alone.
- 3.2 There is clearly an important link between extortionate credit and excessively high interest rates and CABx all over England and Wales regularly report their concerns. However, to concentrate on the interest rate as the indicator that a credit agreement is extortionate is an unduly narrow approach. The increasing sophistication of the consumer credit market, and the imbalance of information between creditors and consumers, is resulting in reports from CABx about agreements that should be considered extortionate, but not simply because of the rate of interest charged.
- 3.3 The evidence in this section of the report considers CABx reports on high interest loans and then turns to the issue of agreements that are extortionate because they breach the principle of fair dealing.

Extortionate credit and high interest loans

- 3.4 Evidence from CABx about high interest loans falls broadly into four key areas:
- secured lending;
 - lending to low income groups;
 - lending associated with specific purchases; and
 - the rapidly growing sector of lending to consumers with impaired credit records.

These areas are not mutually exclusive. For instance, one common factor of being an impaired credit borrower is to be in receipt of a low income. In all four areas our evidence shows that the existing legislation fails to protect consumer borrowers because it does not ensure that extortionate credit agreements are eliminated from the market.

Secured lending

- 3.5 A basic principle in the consumer credit market is that there is a relationship between the risk taken in making a loan and the rate of interest charged. Where a lender has security for a loan it would be normal to expect a lower rate of interest than if there was no security. However, CABx are providing evidence of lenders taking security and still charging levels of interest that would be high even for unsecured borrowing. Where a lender has adequate security and still charges high

levels of interest then we consider that consumers need to be protected by more effective extortionate credit legislation.

A CAB in the East Midlands reported a car hire purchase agreement⁹ with a stated annual percentage rate of 53.6%. The purchase price of the car was £1400 and the credit agreement required the borrower to repay £3045 over two years.

A CAB in Surrey reported a secured loan for £5,800 taken out in April 1989. Payments were £153.06 over 15 years at an annual percentage rate of 36.3%. If the client had made all payments on time the total amount payable would have been £27,550. However, the client missed some payments and various additional charges were made by the lender as a result. As at March 2000, the client had repaid £19,519. This means that the client has paid £684.92 less than he should have done under the loan contract. The lender advised that the amount required as at March 2000 to redeem the loan was £40,617. Payment of this amount would mean that the client paid over £60,000 in eleven years for an original loan of £5,800

- 3.6 A further body of CAB evidence on high interest secured loans centres on the area of debt consolidation. The following examples are typical.

A CAB in Cheshire reported an elderly lady who had been recently widowed. She and her late husband had repaid their mortgage some years earlier but had subsequently taken on a consolidation loan to repay some other debts. The loan was secured against their home and the annual interest rate was 30.5%. The CAB state that the client was unaware of the fact that she could lose her home on non payment of the instalments and that the reduced income of the client following her husband's death meant that continuing repayment at the current level would be very difficult.

A CAB in Greater Manchester reported a 65 year old married man living on a limited pension income. In 1989 he had borrowed £2,600 to finance debt repayments. This was to be paid at the rate of £79.22 per month for 180 months. The APR is 43.1% and the total to be repaid over the term of the loan agreement is over £14,000. The client has maintained repayments to date but will find it difficult to repay in retirement.

- 3.7 The rapidly increasing level of debt carried by consumers in the United Kingdom means that debt consolidation loans are likely to form an increasingly prominent feature of consumer lending. We have particular concerns about such lending and make specific recommendations in Section 5.

⁹ Hire Purchase agreements constitute secured agreements because failure to repay can result in the repossession of the item purchased with the credit advance

Low income groups

- 3.8 Various reports¹⁰ have demonstrated the reluctance of the major banks and financial institutions to lend to low income consumers. At the same time, the provision of loans from the social security system through the Social Fund is restricted to recipients of a limited range of social security benefits. Yet, access to a relatively small amount of credit to meet irregular or unanticipated expenditure can be an essential means of budgeting on a low income.
- 3.9 Low-income consumers' need for credit has resulted in the development of a sector of the financial services industry that concentrates on providing credit to this group. Such credit can be very expensive.

A CAB in Gloucestershire reported on a loan of £800 taken out in March 2000 by a single parent in receipt of Income Support. The loan is repayable at £18 per week over 80 weeks with an interest charge of £640. The total repayable is £1440 and the APR is 132.5%

A CAB in the East Midlands reported the case on a low-income client who borrowed £300 to finance the deposit of rented accommodation. The APR on the agreement is in excess of 200%.

Another CAB in the East Midlands reported a loan of £500 repayable over two years at £58.73 per month. The APR is 239.7% and the total repayable £1409.52

A CAB in South Wales reported a loan for £500 repayable over 40 weeks at £20 per week. The total repayable is £800 and the APR is 266%

- 3.10 In addition to reports of very high interest rates we have been receiving alarming evidence of the unfair practices of some companies that specialise in providing credit to low income borrowers.

CABx in the North West recently reported on a new practice by a mail order company. Instead of orders being placed and monies paid through a neighbour or friend who acts as the agent for the company, an appointed company representative is calling to take orders and collect payments. However, an interest charge of 35%(90.5% APR) is added to pay for the 'extra service' provided by the representative. One CAB details a client who purchased a suite through the catalogue, paid £15 per week for 40 weeks in what she thought would be full settlement

¹⁰ See, for example, Access to Financial Services, Report of Policy Action Team 14, HM Treasury (November 1999)

of the amount due but was then referred to the interest charge. The CAB report that their client was unaware that she was receiving any 'extra service' in respect of the transaction – she was simply ordering from and paying a person who called at her house in the way that mail order catalogues have always operated.

A CAB in the West Midlands reported the case of a disabled client who took out two loans with a local loan company. The first loan was for £50, of which the client received £30. The second loan was for £25 with the client receiving £15. The money retained by the lender was described as 'interest up front'. The client has repaid £20 and has been told that she still owes £67. The Loan Company has taken her wedding ring, watch, kettle, and radio as security for the loan.

- 3.11 Lending to low income consumers is undoubtedly a growth industry. Recent developments include companies that provide a lending facility to low income borrowers based on an extension of the pawn shop principle. The 'loan' is not expressed as a credit agreement because the consumer sells an item to the trading company with the right to buy back the item at a higher price within a specified period of time. Some of the reports from CAB on the practices of these companies are particularly worrying.

A CAB in Merseyside reported the case of a client who received £45 by providing security of a television/video recorder that he had purchased for £500 twelve months previously. The item was recoverable by him repaying £56.25 within 28 days. This is equivalent to an APR of 1355%. Due to confusion over the date on the contract the item was sold before the client could recover it. The sale price was £120.

A CAB in West Sussex reported the case of a client who borrowed £150 by providing security of his stereo valued at £500. The amount has to be repaid within 28 days at an interest charge of £42. This equates to an APR of 1834.3%.

- 3.12 The provision of credit to low income consumers is a growth market in which significant profits can be made. For example, in February 2000, Provident, the largest company understood to specialise in lending to low income consumers, announced that pre-tax profits for 1999 were up 8.5% to £155 million¹¹. This was despite start up losses of £8.4 million caused by a rapid expansion of lending in Poland and the Czech republic where customer numbers had increased from 18,000 to 149,000.

¹¹ Provident Financial Services 1999 Annual Report

- 3.13 We accept of course that commercial enterprises need to make a profit from their business activities. The problem is the lack of fair credit provision to low income consumers. At a time when access to credit (and other financial services) for these consumers is becoming increasingly important to allow them to meet the challenges and opportunities of the UK economy, their access to credit and other financial services is very restricted. The result is that low-income consumers too often face financial exclusion and are forced to borrow at excessively high rates of interest.

Lending associated with specific products

- 3.14 One puzzling aspect of high interest loans is why borrowers take them out when lower interest rate loans appear to be readily available. CAB evidence suggests that many borrowers are introduced to the high rate loan as an adjunct to a major purchase. Evidence from CABx identifies sales of three products as consistently resulting in high interest loans; a replacement car, installation of new windows, and improvements to a kitchen. The sales tactics that introduce consumers to these high interest loans can often be oppressive as the following cases demonstrate.

A CAB in Bedfordshire reported a single woman in her 30's who wanted to renovate her kitchen. She had two savings policies about to mature that would more than cover the anticipated cost. However, the representative from the kitchen company advised her that she would be better keeping her savings for a rainy day and that he could arrange the necessary credit to finance the work on the kitchen. Twelve months later the client has received a statement from the finance company showing that her monthly payments of £93 have not been covering the interest on the money borrowed and she therefore owes more than she borrowed in the first place.

A CAB in West London reported a client who took advice after signing a high interest agreement for the purchase of a kitchen costing £2,000. The client actually had the cash in his bank account to finance the purchase but was told that it was company policy only to accept payment under a finance agreement facilitated by them.

A CAB in Lancashire reported a client who installed replacement windows in her home. The total cost was £5,150 and after paying a deposit of £1,150 she was persuaded by the window company to take out a loan arranged through them. The agreement required the client to pay £96.48 per month over ten years but the bureau report that the client was unaware that the loan was over such a long period. After three years the client realised that she could get a better credit deal elsewhere and she asked for a settlement figure which was subsequently

quoted as £6,323, £1,173 more than had been borrowed in the first instance.

A CAB in Wiltshire reports clients taking on high interest credit agreements to purchase double-glazing. A substantial discount on the price is promised but only if the clients take out a finance deal payable over ten years.

- 3.15 It can be argued that these borrowers make their own decision to sign the loan agreement. In cases where the agreement is signed at the home of the borrower, following face to face discussions with the credit provider's representative or the supplier of the goods, the statutory 'cooling-off' period allows reconsideration, and comparison of other loan agreements. The reality is very different. If our evidence is typical of the average consumer in the UK, then there is a great lack of confidence in choosing between credit agreements, particularly when faced with high pressure selling techniques.
- 3.16 The Government's stated aim in the 1999 Consumer White Paper is to provide people with the skills, knowledge and information they need to become demanding consumers. The CAB Service agrees with these objectives. We consider that there is a pressing need for consumers to be provided with more detailed information about the cost of taking out a particular credit agreement, as well as comparative information about possible alternative agreements. Specific recommendations are included within Section 5.

Impaired credit lending

- 3.17 The problems faced by some consumers in accessing financial services have resulted in the rapid growth of what has become known as the 'impaired credit' industry. This consists of lenders willing to lend to 'non-standard' borrowers who are unable, or believe themselves unable, to obtain credit from mainstream lenders (banks, building societies, and large finance houses). The reasons for refusal are varied. Some borrowers will have had previous repayment problems and have an adverse credit record. Others may be unemployed or disabled. Yet there are others who may be far better able to maintain repayments than some 'credit-worthy' borrowers. This group includes many of the self-employed and those who do not have a previous credit record.
- 3.18 The impaired-credit industry is becoming big business. A recent report¹² calculated that in 1998, £14 billion, equivalent to 6.3% of UK lending, was to non-standard borrowers. Moreover, there is strong potential for growth of this market. The same report calculated that over eight million people, representing 22.9% of the population in the United Kingdom aged 18-65 were non-standard borrowers who could be looking to access impaired credit lenders. As with many of the

¹² UK Non-Standard Lending 2000 – Datamonitor. The figures include mortgage lending

developments in the UK credit industry over the past twenty years, the development of products specifically aimed at 'non-standard' borrowers has been imported from the USA, many new entrants to the UK market have American backing.

- 3.19 Borrowers who use impaired credit lenders do so either because they believe that mainstream lenders will not lend to them or they have been previously refused credit by mainstream lenders. Yet loans from impaired lenders cost more than those from mainstream lenders. Borrowers end up making higher overall payments than they would under a similar credit facility from a mainstream lender. In some cases reported by CABx, the repayment figures are extremely high.

A CAB in the West Midlands reported the case of a client who took out a short-term loan with an impaired credit lender. He borrowed £4,500 and was charged £450 per month interest for three months after which he had to repay the loan in full. The APR on this agreement is calculated at 214%.

A CAB in London reported a loan for £5,000 taken out in October 1999. The client has to repay £296.22 per month for 59 months and a final payment of £196.22 making a total repayable of £17,673.20. The APR is 95%.

- 3.20 We have already referred, in paragraph 3.6 above, to the issue of debt consolidation loans secured on property. We also have disturbing evidence on unsecured debt consolidation loans provided by impaired credit lenders.

A CAB in Wales reported the case of a 21 year old man who bought a car stereo through an impaired credit lender. After making several monthly payments on schedule it was suggested that he take out a further loan to pay off the existing loan and his other credit card debts. The client went to the offices of the lender and signed a new agreement with an APR of over 50% - very much higher than the interest rate charged on the credit cards.

A CAB in Berkshire reported the case of a disabled widower aged 72 who had one loan from an impaired credit lender. He had difficulty in maintaining the payments and the loan company allowed him a consolidation loan of £140 to repay the first debt. The client is to repay £7 per week over 30 weeks, making a total repayment of £217. The APR is 365.1%.

A CAB in West Yorkshire reported the case of a client faced with bailiffs' action for repayment of council tax arrears. The client borrowed £350 from an impaired credit lender to pay the arrears and signed a loan agreement to pay back £500 at the rate of £50 per week. The bureau report that the client was on Income

Support at the time of signing the loan agreement and that there is no way that she can afford to repay £50 per week from her income.

- 3.21 A consolidation loan to clear existing debts is often an attractive idea to an indebted consumer and may be perceived as a responsible action. However, in many cases where a debtor is seeking a consolidation loan from an impaired credit lender, the reason will be because of existing or past financial pressure. This will result in the new loan being high interest or long term, or both. Also, in many cases a consolidation loan will be secured on property when the original loans were not. In such instances, a consolidation loan is not likely to be the best option for the debtor.
- 3.22 The CAB Service is increasingly concerned at CABx reports where it is difficult to avoid the conclusion that the lender has been more interested in the equity position in the borrower's property than the ability of the borrower to repay the loan.

A CAB in the North East reported a case where a client took out a secured loan with an impaired credit lender and subsequently fell into arrears. The response of the lender was to offer a second secured loan. Once both loans showed payment arrears the lender sent a 'debt counsellor' to visit the client, with the result that a third loan was arranged. The CAB were approached for advice only after possession orders had been granted on all three loans and the client was facing imminent eviction.

A CAB in Suffolk reported the case of a client who took out a secured loan to repay non-priority debts. The total proportion of income taken up with housing costs then increased to 51% of the client's net income. The CAB comment that it is likely that the home will eventually be lost.

- 3.23 Most mainstream lenders seem content to keep a watching brief on the activities of impaired credit lenders. Yet mainstream mortgage lenders are heavily promoting the take up of products such as flexible mortgages that acknowledge that the average consumer will have times in their life when they are under financial pressure. We would like to see mainstream lenders taking a more positive approach to lending to consumers who have had previous repayment problems. This could be through a re-evaluation of their credit scoring policies, development of products that would be appropriate for such borrowers, and/or greater support for credit unions and other forms of social lending. The Government could play a greater role in this area by reviewing the Social Fund as promised in 1999.¹³

¹³ Access to Financial Services, Report of Policy Action Team 14, HM Treasury (November 1999)

- 3.24 It also seems unsatisfactory that a large number of the adult population may be excluded from accessing the more competitive credit products simply because they are self employed or do not have a previous credit history. This experience suggests strongly that mainstream lenders may be over-reliant on blunt ways of assessing credit worthiness.

The principle of fair dealing

- 3.25 Extortionate credit is not simply evidenced by excessively high interest loans. Many credit agreements have onerous terms and conditions that give an unfair advantage to the credit provider over an ill-informed consumer borrower. Such agreements should be controlled by effective legislation. Their persistence in the market place is evidence of the need for changes to the legislation. The following examples illustrate the range of unfair terms used:

A CAB in Berkshire reported on a novel approach from a loan broker. Potential borrowers are told that they are eligible for a loan on which they can reclaim 100% of the interest payable under the agreement. The CAB client who took up this offer was provided with a loan of £5,750 secured against his home, including an insurance premium of £750. The CAB reports that examination of the terms and conditions for repayment of the interest suggests that the client would never be able to reclaim the interest because the client would never be able to meet the qualifying conditions.

A CAB in Lancashire reported that a client purchased a television set on an 'interest-free' agreement. The client had eighteen months to pay for the television. A monthly direct debit was set up and the client also made additional payments. Towards the end of the eighteen months the client contacted the Credit Company and asked how much he had left to repay. He was told that £200 was outstanding and he paid over this amount. Subsequently the credit company contacted him and informed him that there was an outstanding balance of £15 to which had been added an interest charge of £485 as the original debt had not been cleared within the eighteen months allowed.

A CAB in West Yorkshire reported on the case of a client who owes just over £20 on a mail order agreement. The client is in financial difficulty and has been paying back only a small amount per month, normally around £3. However, the Company has been charging a monthly 'reminder fee' of £3 and so the debt is not reducing.

A CAB in Northamptonshire reported the case of a client who has been charged £120 in 'legal fees' because he was one day late in making a payment due under a loan agreement.

- 3.26 A CAB in Leicestershire report on an example of a very common type of credit agreement that was taken out with a mainstream lender which very quickly escalates into what we would consider to be extortionate credit.

The CAB client purchased a fridge/freezer costing £298. A deposit of £16 was paid leaving credit of £282 to be financed. The client was asked to pay at the rate of £12 per month. The quoted APR was 27.8% if payments were made by Direct Debit or 32.4% in all other cases.

The initial interest on the credit amounted to £7.14 per month and the payment protection insurance on the loan added a further £2.34 per month. Very slowly the balance on the loan reduced but five months in to the agreement the client missed a payment. A reminder letter from the creditor added £20 on to the debt. Subsequent months saw the client miss payments but then catch up with double payments. Nineteen months in to the agreement the client has paid a total of £228 (i.e. the equivalent of nineteen payments of £12). The lender has added on £205 in charges for letters advising of late payment, the total amount now outstanding under the agreement has increased to £483.06 and the APR has been increased to 34%. Interest and insurance charges now amount to over £15 per month.

The bureau comment that they 'would like to ask the court to reopen the agreement under the extortionate credit provision of the Consumer Credit Act but the client is a lone parent and reluctant to risk the application fee. As she is not actually receiving a means tested benefit we doubt we can convince the court to waive the fee.'

- 3.27 The terms of the contracts in the cases summarised above appear to be grossly unfair. The Unfair Terms in Consumer Contracts Regulations have been a significant advance in the protection of consumers against onerous terms and conditions. However, the exclusion from the Regulations of 'core terms' within agreements, a principle core term being price and charges, means that the Regulations are not as effective as they could be. In Section 4 we make recommendations designed to ensure that borrowers entering into consumer credit agreements can benefit from the unfair terms legislation.

Part Two: Solving the problem of extortionate credit

4. Reform of legislation

- 4.1 There is no doubt that extortionate credit is a persistent and undesirable feature of the UK consumer credit sector and significant consumer detriment will continue unless effective measures are put in place to solve the problem.
- 4.2 Action is needed on more than one front. Our evidence shows that there is an urgent need to address the deficiencies of the existing legislation and this chapter puts forward our recommendations. We firstly discuss the changes that should be made both to the existing extortionate credit legislation and to the court process to provide a better balance between the interests and the needs of creditors and borrowers. We then discuss how the Unfair Terms in Consumer Contracts Regulations could be amended to provide an additional and complementary means of regulating extortionate agreements. Finally, we examine the argument in favour of a 'ceiling' on interest rates as a simple and transparent method of removing high interest agreements from the UK consumer credit sector.
- 4.3 The use of legislation to counter extortionate credit is a mechanism to address the failure of the consumer credit market. If borrowers were fully informed and better educated in the use of credit, and all income groups had access to a range of competitively priced products, then the market would ensure that extortionate credit was rarely encountered. Section 5 of this report makes recommendations to help ensure that consumers can avoid extortionate credit in future by making informed borrowing decisions. We also address the problem of providing affordable credit to those consumers who currently find their choices limited to impaired credit lenders.

The test for extortionate credit

- 4.4 Sections 137 –139 of the Consumer Credit Act came in to force in May 1977. Any expectation that the new regulations would lead to a rush of borrowers anxious to seek the protection of the court from extortionate credit agreements was soon dashed. By 1991 the Office of Fair Trading was able to identify just fifteen cases where courts had been asked to exercise its power¹⁴. More recently, another survey concluded that by the summer of 1999 there had been in the region of only 30 to 40 cases where an argument over extortionate credit had reached trial¹⁵.

¹⁴ Unjust Credit Transactions 1991

¹⁵ Robert Rosenberg: When is an Agreement Extortionate? Quarterly Account Winter 1999/2000

- 4.5 Where borrowers have taken the opportunity to seek the protection of the court, the courts have mainly found in favour of the creditor. For example, in 1986 the Court of Appeal declined to reduce a secured loan with an annual percentage rate (APR) of 42% in the case of *Woodstead Finance Ltd v. Petrou*. Westminster County Court upheld a second mortgage APR of 32.4% in the 1990 case of *Ceoularton Acceptance Ltd v. Alexandrou*. A remortgage at an APR of 39.4% was found to be not extortionate by Birmingham County Court in the 1991 case of *Pennie v. Northmount Securities*.
- 4.6 Some credit industry commentators have suggested that the small number of cases reaching the courts is an indication that extortionate credit is just not a problem in the UK. We disagree. In our view, the reason that the law has been seldom tested is that the current law is badly framed and needs urgent rewriting. The Office of Fair Trading and the then Government declared this to be the case nearly a decade ago and in this context it is hardly surprising that consumers and advisers will not have sought to use a process which offers so little prospect of providing protection from abuse.
- 4.7 The existing legislation is fundamentally flawed in two areas: firstly, the 'test' that defines an extortionate agreement; and, secondly, the procedure for bringing a case before the court.
- 4.8 The existing legislation prescribes that a credit agreement is extortionate if it requires payments that are 'grossly exorbitant'. This is too high a hurdle for a borrower to overcome. The Concise Oxford Dictionary defines 'exorbitant' as 'grossly excessive'. This definition has the result that a credit agreement is only extortionate if it requires payments that are **grossly, grossly** excessive. Similarly, the second strand of the legislation requires that an agreement must not only contravene the ordinary principles of fair dealing but must grossly contravene those principles. Such requirements mean that the legislation could only tackle the far extremes of trading practices.
- 4.9 It is clear that the principle behind the replacement of the interest rate ceiling of the 1927 Money Lenders Act with sections 137-139 of the Consumer Credit Act was to give the courts maximum flexibility in determining whether a credit agreement was extortionate. In practice, the legislation has only served to make it harder for the courts to intervene.
- 4.10 His Honour Judge White commented on the differences between the two sets of legislation in the case of *First National v. Bertrand*[1980]¹⁶; 'Parliament in the 1974 Act has chosen to use very different wording. A credit bargain is not extortionate if it is simply excessive, but only if the payments required are grossly exorbitant or if it grossly contravenes the ordinary principles of fair dealing. The test has been made very

¹⁶ Source: New Law Journal p 1042 November 1982

much stronger. Not only does the word 'exorbitant' replace the word 'excessive' but it is qualified by the word 'grossly'.

- 4.11 Judge White sums up the effect of the existing legislation very accurately but we suspect strongly that this was not the intention of Parliament in replacing legislation that had been considered 'largely ineffective' by the Crowther Committee.
- 4.12 Effective extortionate credit legislation should aim to strike the right balance between the commercial aims and expectations of creditors and the requirement of society to protect consumers from abuse. In the view of the CAB Service, the balance is currently strongly weighted in favour of the creditor. This requires a change in the legal definition of an 'extortionate' agreement.
- 4.13 **The CAB Service recommends that section 138(1)(a) of the Consumer Credit Act 1974 is amended to provide that a credit agreement is extortionate if it requires payments that are excessive given the degree of risk taken by the lender in providing the loan.**
- 4.14 **The CAB Service recommends that section 138(1)(b) of the Consumer Credit Act 1974 is amended to provide that a credit agreement is extortionate if it contravenes the ordinary principles of fair dealing.**

The court process

- 4.15 The existing legislation provides that only the borrower or a surety can make an application to the court where there is an allegation that an agreement is extortionate. There is no provision for the court to raise the matter of its own volition during the course of proceedings. There is also no provision for third parties such as Trading Standards Departments or the Director General of Fair Trading to complain on behalf of a borrower or any provisions for class actions. This means the consumer borrower carries the burden of regulating the market. In an imperfect market this burden is unfair and a major reason why so few cases have come before the courts.

A CAB in Oxfordshire reported of a case where clients took the advice of a broker to consolidate all their debts in to a secured loan. All advice from the broker was given over the telephone and the clients believed that they would be paying £150 per month. The credit agreement that they eventually signed provided a loan on £15,300 plus £1,700 for the broker's fee and a payment protection insurance of £2,380, making a total loan of £19,380. This was repayable over twenty years at a monthly instalment of £305.24. The total repayable was £73,257. At the time of signing the agreement the clients had suffered a family

bereavement and did not pay sufficient attention to the terms of the agreement.

The clients complained to the local Trading Standards Office who referred the case to the Office of Fair Trading and also to the CAB. The CAB comment, 'Whilst it is clear to see that this mortgage is either an Extortionate Credit Bargain or certain conditions in the contract are unfair within the meaning of the Unfair Contract Terms Act, to do anything about it will, we understand cost our clients around £500 in fees alone'.

- 4.16 Evidence from CABx shows that borrowers are extremely unlikely to raise extortionate credit allegations with the courts, mainly because its current legislation is weighted against them. However, there are also the significant hurdles of the costs and complexity associated with an application.
- 4.17 The cost of using the courts to seek redress has increased considerably. The CAB Service has argued in submissions to the Lord Chancellors Department¹⁷ that these costs are proving to be an obstacle preventing many individuals from using the legal system.
- 4.18 The 1999 increases in court fees mean that an initial charge of £120 will be required if the borrower makes an originating application to reopen a credit agreement. In the case of extortionate credit applications, there are then two further cost issues; legal representation, and the risk of costs being awarded against the borrower.
- 4.19 The Consumer Credit Act is primarily an Act to protect consumers. Yet regrettably, it is a particularly difficult piece of legislation to interpret. Even Judges have reported finding it unduly complex. For example:

In Jenkins v. Lombard North Central plc [1984] Lord Justice Goff described the CCA as '...an Act of extraordinary length and complexity which must raise very considerable problems for those...citizens, whether corporate or individual, who are affected by its terms'.

In Davies v. Directloans Ltd[1995] a High Court judge concluded his judgement by saying, 'I should like to express my indebtedness to counsel for their assistance not only in relation to the somewhat convoluted provisions of the 1974 Act and of the regulations made under it, but also for the clarity with which they explained some of the mathematical calculations involved in the ascertainment of true rates of interest which are of such vital importance in applying the Act'.

¹⁷ Briefing on new and higher court fees – Submission to the Lord Chancellor's Department by the CAB Service, January 1997 and Civil court fees: consultation on fee changes – A response by the CAB Service, February 2000

- 4.20 Because the Consumer Credit Act is such a difficult piece of legislation to interpret and that there have been so few decisions made under sections 137-139, a CAB is extremely unlikely to advise an unrepresented borrower to make an application to reopen an agreement. The services of a solicitor or barrister will almost certainly be required. This of course intensifies the issue of costs. The quality of the legal advice available to borrowers is also an issue. In such a specialist field, with very limited caselaw, it is invariably the case that the expert lawyers regularly advise and act on behalf of lenders. Such lawyers are therefore not available to advise consumers. Very few high street practices willing to act for borrowers can match the specialists for experience and technical know how. Consequently there is a significant imbalance in the quality of advice available to lenders and to borrowers. Borrowers will not therefore be litigating on a level playing field.
- 4.21 There is a further issue with regard to costs. If the allegation of extortionate credit is successfully defended, the borrower will almost certainly be ordered to pay the creditor's costs. Given that the creditor organisation is likely to have instructed specialist legal opinion to advise and represent on the complexities of the Act, the costs could be considerable. NACAB has been told of a recent case where a borrower did make a claim for an agreement to be reopened on the basis that it was extortionate. The eventual bill for the costs of solicitors, counsel, and expert witnesses was in excess of £26,000. The borrower's claim was successful and the creditor should therefore meet the costs, but most consumers would be very unlikely to risk even a small percentage of such a bill.
- 4.22 The issue of costs has to be considered by any person or organisation considering legal action. But it is not in the wider interests of consumers, or society as a whole, if an imbalance of bargaining power and financial resources prevents a possible extortionate credit agreement from being decided by the only recourse available - the court. It is therefore necessary to consider other ways for such agreements to come before the judiciary.
- 4.23 One means of alleviating some of the burden of individual consumers would be to enable judges to act on their own initiative to open agreements. In Spring 2000 the Department of Trade and Industry issued a consultation paper seeking views on this proposal.
- 4.24 **The CAB Service supports the Department of Trade and Industry's proposal that judges are allowed to consider whether a credit agreement is extortionate without the need for an application from the borrower. The Department should act quickly to implement this proposal.**

- 4.25 This recommendation is not without its practical difficulties (and would be of very limited benefit without changes to the legal definition of extortionate credit). The key difficulties are:
- Credit agreements normally only come before a court where there has been payment default and legal action taken by the lender to enforce the agreement. Possible extortionate credit agreements that proceed without default, or where lenders seek to recover arrears without issuing proceedings will therefore be at no risk of intervention by a judge.
 - In the vast majority of cases where a possibly extortionate agreement is the subject of legal action, the amount owed will not be disputed by the borrower and will therefore not be seen by a judge.
 - There will be some cases where the borrower has no wish to see the agreement reopened on the basis of extortionate credit and therefore would not want the court to intervene.
 - The information provided in the particulars of claim will provide the judge with information on the terms of the agreement but will provide little indication of whether the agreement may be extortionate through a contravention of the ordinary principles of fair dealing.
 - There is the question of how the costs of the court procedure and of the parties should be met where the court investigates an agreement.
 - District Judges may feel uncertain about how to exercise the responsibility of being required to consider whether an agreement may be extortionate without any request from the borrower. When in doubt they may play safest by not intervening.
- 4.26 Despite these difficulties, the CAB Service believes that if judges could consider the reopening of a credit agreement without an application from the borrower this could make a contribution to tackling the problem of extortionate credit. We have other recommendations to help overcome the practical issues identified above.
- 4.27 **The CAB Service recommends that form N9A (form of reply where the debtor is not disputing that a debt is due but is seeking time to repay the amount claimed) is amended to include the question, ‘Do you want any credit agreement that forms the basis for this claim to be referred to a judge for consideration of whether the agreement is extortionate?’ If the answer to this question is ‘yes’, then the borrower should be asked to explain the reasons why the agreement is considered extortionate.**

- 4.28 **The CAB Service also recommends that form N11M (form of reply to mortgage possession claim) is amended to include the question, ‘Do you want any credit agreement that forms the basis for this claim to be referred to a judge for consideration of whether the agreement is extortionate?’ If the answer to this question is ‘yes’, then the borrower should be asked to explain the reasons why the agreement is considered extortionate.**
- 4.29 The above recommendations would provide the practical means for a borrower to alert the court to a possible extortionate credit agreement without the need for a formal application. It would also help avoid the situation where a judge decides that a loan should be reopened but the borrower fails to attend any subsequent hearing because of no desire to become involved in the matter. It would also allow the borrower to inform the court of reasons as to why the agreement may be extortionate because of a contravention of the ordinary principles of fair dealing rather than the rate of interest charged.
- 4.30 If these recommendations are to have any practical effect the court must be provided with detailed information concerning the credit agreement so that a judge can give consideration as to whether the agreement merits further consideration of being extortionate. The borrower must also be provided with information about the circumstances that might render his or her agreement an extortionate credit bargain.
- 4.31 **The CAB Service recommends that the current requirement for a claim for recovery of monies outstanding under a credit agreement to include a copy of the original credit agreement should be enhanced to require in addition a statement of all debits and credits applied to the loan agreement since inception.**
- 4.32 **The CAB Service recommends that all claims for recovery of money lent under credit agreements include a fact sheet explaining the legislation covering extortionate credit which includes examples of agreements and situations where a court may consider it appropriate to further investigate an allegation of extortionate credit.**
- 4.33 We have already referred to the fact that the Consumer Credit Act is a complicated piece of legislation that is inaccessible to the average unrepresented consumer. We have also explained how it will be extremely difficult for an individual borrower to take the risk of applying to the court.
- 4.34 **The CAB Service recommends that specified third party agencies such as Trading Standards Departments and the Office of Fair Trading be allowed to apply to the courts for consideration of whether an agreement is extortionate. It is in the public interest that extortionate credit bargains are tackled so, we also**

recommend that the costs of these actions should normally be met by the creditor where the court finds that the agreement is extortionate. In other cases costs should be met from public funds, unless the court is of the view that the application from the third party agency was vexatious or frivolous.

- 4.35 If judges are to play a more significant role in determining whether a credit agreement may be extortionate they need more information, training, and guidance on applying the legislation. This should include regularly updated information on the charges associated with various types of credit agreements.
- 4.36 **The CAB Service recommends that the Office of Fair Trading collates and publishes information on average interest rates charged on different types of secured and unsecured credit agreements, and makes this available to both District Judges and the public. This information could also be used to improve the information available to borrowers before a credit agreement is entered in to (see paragraph 5.9 below).**
- 4.37 Individual cases of extortionate credit may be evidence that other consumers with contracts from that lender are also experiencing detriment. Where market practices are regulated through individual cases and actions rather than through generally applicable rules, the challenge is to find a way of enabling other consumers to benefit from judgments without the need for the consumer to go to court, incurring the costs and complexity this entails. However, the fact that a court has found that one particular agreement is extortionate will not necessarily mean that all similar agreements would also be extortionate because of the need to take account of risk factors, and terms may vary.
- 4.38 Where a court finds that a credit bargain is extortionate the CAB Service believes that consideration should be given to whether other loans from the same lender should also be open to challenge. Later in this section, we discuss how the Unfair Contract Terms Regulations could be particularly beneficial to this problem. In addition, access to a central record of cases where courts had considered the question of extortionate credit would assist consumers and third parties to decide whether to take action on similar agreements. We also consider that any finding of extortionate credit should raise wider questions concerning the business practices of a lender. In such cases there should be an obligation on the Office of Fair Trading to investigate the fitness of the lender to continue to hold a consumer credit licence.
- 4.39 **The CAB Service recommends that a central record should be available to the public of all cases where the courts have considered the question of extortionate credit.**

- 4.40 **The CAB Service recommends that any finding of extortionate credit should result in an obligation on the Office of Fair Trading to consider the fitness of the lender concerned to continue to hold a licence under the Consumer Credit Act 1974.**

Variation in interest rates

- 4.41 The majority of credit agreements entered into by consumers are variable interest agreements. This means that the rate of interest can be changed, generally at the sole discretion of the lender. There is, however, a lack of clarity in the existing extortionate credit legislation which means a court may not be able to take such changes in interest rate into account in determining whether an agreement is extortionate.
- 4.42 CABx frequently report situations where finance companies have decided not to reduce their interest rates further to a reduction in base lending rates.

A CAB in Surrey reported the case of a client who, in August 1988, took out a loan secured on her property. The interest rate at the inception of the loan was 17.34%. By September 1999, the interest rate had been varied at the discretion of the Loan Company to over 19%. In August 1988 Bank Base Rate was 11.0%, in September 1999 it was 5%.

A CAB in London reported a loan of £3,600 taken out over ten years. At the end of the ten-year period the client ceased payments and consulted the CAB when he was informed that he still owed £3,000 on the agreement. The CAB investigated and discovered that the interest rate on the agreement had been increased in 1991 and did not reduce until 1994. The client had been informed of the interest rate rise but was not asked to increase his payments nor was he informed of the effect that the increase would have on his overall indebtedness. The remaining balance on the agreement was caused solely because of the increased interest charges and the compound effect of interest on interest.

- 4.43 The existing legislation is open to interpretation as to whether an extortionate credit determination should consider changes in the interest rate during the course of the agreement. The wording of section 138(2)(a) directs the court to consider interest rates prevailing at the time the agreement was made. Professor Goode, the leading academic authority on the Consumer Credit Act, expresses the opinion that 'whether the credit bargain is extortionate has to be determined as at the date of the credit agreement, not in the light of subsequent events'¹⁸. The implication is clear: any change in the rate of interest

¹⁸ Paragraph 2914; Consumer Credit Legislation (Goode)

charged is not a factor that the court can take into account in determining whether an agreement is extortionate.

- 4.44 Other commentators have questioned the view of Professor Goode, and the correct interpretation of section 138(2)(a) is uncertain. Yet again the wording of the legislation hinders individual consumers and those advising consumers.
- 4.45 It seems to us to be extremely unsatisfactory that a creditor can either unilaterally increase the interest rate on an agreement or fail to follow a reduction in base rates and then argue that the court has no power to consider the matter within the extortionate credit legislation. This is another example of the legislation being cast in a way that failed to take account of the likely market changes. It should be clear that the court has the option of taking interest rate changes into account in examining the credit agreement.
- 4.46 **The CAB Service recommends that section 138(2)(a) is amended to specify that the court is empowered to take in to account the interest rate charged over the whole term of the credit agreement in any determination of extortionate credit.**

The question of timing

- 4.47 There is a further technical issue in the consideration of extortionate credit that causes significant problems for consumers and advisers. The Limitation Act 1980 sets down time limits for applications to be made to a court. Until recently, various county court decisions had established that the period during which borrowers could raise the allegation of extortionate credit lasted for six years from the date the loan agreement was made. Thereafter, the borrower was barred from taking action.
- 4.48 In the view of the CAB Service, this was an entirely unsatisfactory situation. Many high interest secured loans are repayable over a term of between fifteen and twenty-five years. The lender has the right to seek possession of the home of the borrower if there is default at any period during the term. Yet the law seems to deny the borrower the option of asking the court to re-open the agreement once the loan had been running for more than six years.
- 4.49 A recent Court of Appeal decision has improved the situation somewhat. In the case of *Rahman v. Sterling Credit Ltd* (CA 20 July 2000) the court has determined that the time limit for borrowers raising the issue of extortionate credit is actually twelve years from the date of the loan agreement. It is very helpful that the Court of Appeal has clarified the law and we welcome the judgment. Nevertheless, it still leaves the anomaly whereby borrowers that enter into agreements lasting more than twelve years may have no recourse against any extortionate practice in the latter years of the loan.

- 4.50 It seems to us to be common sense that a borrower should always have the right to ask the courts to consider an alleged extortionate credit agreement for at least so long as that agreement remains payable.
- 4.51 **The CAB Service recommends that borrowers should be allowed to seek the protection of the courts under the extortionate credit provisions for so long as the loan agreement continues.**

Unfair terms in consumer contracts regulation

- 4.52 We have already explained how existing section 138 of the Consumer Credit Act prescribes that a credit agreement is extortionate if it requires payments that are grossly exorbitant'. We have also recommended that the legislation should be changed to introduce a more reasonable hurdle for borrowers to overcome. However, there is complementary way in which excessive rates of interest might be challenged.
- 4.53 Since July 1995, consumers facing credit agreements that do contravene the ordinary principles of fair dealing have had some redress. In 1993 the European Commission published Council Directive 93/13/EEC. This required European member states to introduce legislation ensuring that consumers had protection against any standard contract term that was unfair. The Directive defined an unfair term as one that had not been individually negotiated and which, contrary to the requirements of good faith, causes a significant imbalance in the parties rights and obligations under the contract to the detriment of the consumer.
- 4.54 The European Directive was originally implemented in the UK through the Unfair Terms in Consumer Contracts Regulations 1994. The Regulations came into force on 1st July 1995 and were subsequently amended by the Unfair Terms in Consumer Contracts Regulations 1999.
- 4.55 A particularly notable feature of the Regulations is that they empower designated organisations such as the Office of Fair Trading and the Consumers Association to take action on behalf of consumers without the consumer themselves being put at a cost risk from such action.
- 4.56 The Unfair Terms Regulations have had a major impact on consumer protection in the UK. Some credit agreements have been significantly amended as a consequence. For example, NatWest Bank have been forced to withdraw unfair redemption charges in fixed rate mortgages, and City Mortgage Corporation required to withdraw a loan condition that allowed a higher rate of interest to be charged where borrowers were in default on payment. The National Audit Office has estimated that the last change alone has saved consumers over £65 million

pounds a year.¹⁹ Importantly, a single action will apply to all contracts containing the offending term.

- 4.57 National Governments were given discretion in implementing the European Directive 93/13. In particular, each member state could choose whether or not 'core terms' within a consumer contract should be subject to the Regulations. Seven EU countries²⁰ decided not to include such an exclusion clause. The UK Government decided that the core term exclusion should form part of national law.
- 4.58 The rate of interest payable under an agreement is normally considered to be a 'core term'. As such, a high rate of interest can never form the basis for a successful complaint under the Unfair Terms in Consumer Contracts Regulations as currently implemented in the UK.
- 4.59 The inclusion of 'core terms' within the United Kingdom Unfair Terms Regulations would make it possible for borrowers and designated third party agencies to bring pressure on creditors to reduce excessively high rates of interest on the basis that such an excessive rate constituted an unfair term within the loan contract.
- 4.60 The extension of the Unfair Terms in Consumer Contracts Regulations to include 'core terms' would be a positive step forward in redressing the balance between creditors and borrowers. It would also meet the challenge of providing redress for individual consumers without the need for every affected consumer to go to court.
- 4.61 In September 1999, the European Commission began consulting on whether the exclusion of 'core terms' from the European Directive should continue. In the view of the CAB Service, there is a very strong argument for the UK Government following the lead of the seven European nations that did not exclude core terms from Unfair Terms regulations. There seems to be no evidence that the burden on businesses in the seven other countries has been more excessive because of the wider scope of the regulations and the inclusion of 'core terms' in the UK would provide a more level playing field between consumers and credit providers.
- 4.62 **The CABx Service recommends that the Government withdraws the core term exclusion from the Unfair Terms in Consumer Contracts Regulations so that the rate of interest charged within a credit agreement can be considered under the Regulations**
- 4.63 Any implementation of the above recommendation would still leave a crucial role for the extortionate credit provisions of the Consumer Credit Act. There are a variety of situations where the extortionate credit

¹⁹ Page 53. The Office of Fair Trading: Protecting the Consumer from Unfair Trading Practices. National Audit Office 1999

²⁰ Denmark, Ireland, Finland, Luxembourg, Portugal, Spain, Greece

provisions can be applied and the Unfair Terms regulations cannot. For example, the Unfair Terms Regulations only apply to agreements made after 1st July 1995. The Unfair Terms Regulations also only cover contract terms whereas the extortionate credit provisions deal with 'fair dealing' between the parties and can therefore include misleading the borrower or other sharp practices.

Interest rate ceilings

- 4.64 Some commentators have recently argued for a return to an overall ceiling on interest rate levels as a means of countering high interest rate credit agreements. The presumption would be that any agreement with an interest rate above the ceiling level would be considered to be extortionate.
- 4.65 Interest rate ceilings do currently operate in some other European countries and the argument in favour of a ceiling level has a definite attraction in its simple and apparently transparent approach to the capping of interest rate levels. However, the CAB Service is not convinced of its practicality for the UK consumer credit market.
- 4.66 Any overall ceiling rate would have to be introduced at a rate that allowed for unsecured lending to consumers who were considered to be high risk by credit lenders. Such a ceiling could be relatively high. Yet there could be agreements with much lower interest rates that would be strong candidates for review under effective extortionate credit legislation. For instance, a borrower with a faultless previous payment record provides excess security for a loan and takes out insurance to protect the loan payments in the event of unemployment or sickness. In such a case a presumption that this loan could only be presumed extortionate if it had an interest rate above a statutory ceiling would be entirely inappropriate.
- 4.67 The introduction of an overall ceiling rate could increase financial exclusion. Consumers will continue to need credit irrespective of any regulatory intervention on the interest rate or any other aspect of a credit agreement. If a ceiling rate of interest resulted in low income borrowers being excluded from credit facilities then there could be a growth in unregulated and unlicensed lending. It is also possible that the ceiling rate could become the going rate and hence increase the cost of some borrowing.
- 4.68 The interest rate as expressed by the Annual Percentage Rate (APR) figure is not a particularly helpful guide to the overall cost of a credit facility on a small loan. In such cases, the relatively high administrative costs proportional to the amount borrowed results in a high APR figure but one that still represents a non extortionate agreement. For example, we suspect that most readers would initially be concerned if we were to report evidence of a credit agreement with an APR of 153%. However, the same readers may not be so concerned to hear of

a loan of £50 repayable over 20 weeks at a weekly cost of £3 where the lender had the costs of door to door collection. The fact is that we would be reporting on exactly the same loan in both cases.

- 4.69 Other commentators have argued for a more complex and dynamic system of ceilings on interest rates that would allow for different ceilings according to the type of credit. The regulatory system adopted by the French authorities follows this approach. The Banque de France calculates the average market rate of interest for each of six categories of loans for non-business consumers, and these figures are increased by one third to determine the ceiling level. Penal and civil sanctions apply to lenders and intermediaries where this ceiling level is exceeded.
- 4.70 One of the six categories in the French system covers all categories of loans for amounts of less than 10,000 francs (approximately £1,000). The possibility of UK loans being considered extortionate where the rate of interest charged was more than one third of the average market rate for all loans under £1,000 would certainly concentrate the mind of many financial institutions. Companies ranging from door to door collectors with APR's in the hundreds through to the well known institutions that fund store credit cards at an APR of 28% – 32% would be faced with a decision to either reduce their interest rates or withdraw from the market.
- 4.71 Whilst placing a cap on the excessive rates charged by some lenders has its attractions the CAB Service is not convinced of the practicality of this system for the UK. The range of consumer credit products is now so extensive that considerable resources would need to be expended in researching and reviewing the appropriate ceiling rates. There are also social and historic factors that exist in other nations that have influenced the development of interest rate ceilings but which do not apply in the UK. Also, the problem of additional financial exclusion applies just as much to this system of multiple ceiling levels as it does to the single level.
- 4.72 Finally, a credit agreement may be extortionate for reasons other than the rate of interest chargeable. The imposition of a ceiling rate of interest would likely concentrate attention on just one aspect of a credit agreement to the possible detriment of borrowers facing otherwise onerous terms and conditions. German consumer representative have reported the use of loopholes in European Union credit legislation that allow increased costs outside the credit agreement as a way of getting around their ceiling rate of interest. We cannot but think that any ceiling system of interest rates would be met with similar 'avoidance' strategies in the UK.

4.73 The CAB Service is therefore not convinced about the merits of an interest rate ceiling. Instead, we would advocate a revision of the extortionate credit legislation that both changes the definition of extortionate credit and provides an easier mechanism for cases to come before the courts, as proposed above.

5. Solving the problem – empowering consumers

- 5.1 Those people seeking advice from CABx are generally not well-informed on credit and money management. Well-informed confident consumers would be clear about their options and aware of the relative cost of alternative credit agreements. Well-informed consumers would naturally steer clear of the most expensive and extortionate credit agreements.
- 5.2 The 1999 Consumer White Paper emphasised the intention of the Government to better inform consumers, 'Well-informed consumers help markets work effectively. Consumers who can assert their needs clearly and make the best choices spur business to become more competitive and raise productivity. Consumers benefit from this through lower prices, increased choice and more innovative products'²¹.
- 5.3 The ever increasing complexity of the UK consumer credit market makes it difficult for consumers to be well informed and confident in their use of credit. The CAB Service therefore considers it essential that more assistance is given to consumers through information at the point of entering into a credit agreement as well as through general information and education on credit issues.
- 5.4 The CAB Service believes that there is a need to provide more assistance to borrowers in helping them choose between credit agreements. The Consumer Credit Act already requires that a credit agreement provides information concerning the amount borrowed and the APR of credit costs payable. Evidence from CABx shows that this is insufficient information for many consumers to make an informed choice in the use of credit. Too many borrowers concentrate on the monthly payments required under a credit agreement without giving thought to the additional interest payable. Too many borrowers enter into a credit agreement with little idea as to how the terms of that agreement compare with other similar products from other lenders. In our view, consumers should be left in no doubt as to the effect of interest charges on their credit agreement or how those charges compare with similar loans from other lenders.
- 5.5 We have two recommendations that we believe would significantly improve the information available to consumers at the point of sale. Both recommendations could be implemented through Consumer Credit Act regulations and so would not require primary legislation.
- 5.6 Under current regulations, lenders are only required to show the total amount payable over the term of a loan where the interest rate is fixed. Where the rate of interest is variable there is no requirement to show the total amount payable on the agreement but there is an obligation to

²¹ Modern Markets;Confident Consumers – Implementation Plan for the Consumer White Paper (December 1999)

show a 'typical example' information in the small print of credit advertising. We see no reason why this information should not be repeated – in the credit agreement itself. Where credit is advanced under a revolving credit agreement, we suggest that the agreement shows the total amount repayable if the maximum sum allowed under the credit facility is taken up immediately and repaid at the minimum monthly payment.

- 5.7 **The CAB Service recommends that all credit agreements should be required to prominently show the total amount likely to be repayable by the borrower over the term of the agreement.**
- 5.8 We have recommended in paragraph 4.36 above that the Office of Fair Trading should collate and publish information on the average rates of interest charged under different types of credit agreements. We think that this information should be used in a pro-active way to better inform consumers in their use of credit.
- 5.9 **The CAB Service recommends that credit agreements should be required to show the average interest rate for the particular type of loan along side the interest rate figure charged for the specific agreement being offered to the consumer.**
- 5.10 One of the more frustrating features of extortionate credit reported by CABx is that in many cases there is actually no need for consumers to take out excessively high interest consolidation loans. CAB advisers regularly see cases where borrowers have taken on inappropriate loans in order to consolidate existing debts or have remortgaged at a much higher interest rate in order to stave off legal proceedings from their existing mortgage lender. Yet, in many of these cases, if the borrower had taken advice from the CAB or another independent agency before taking on the high interest loan the borrower would have been able to negotiate with existing creditors to remove the financial pressure without the need for more borrowing.
- 5.11 **The CAB Service recommends that lenders providing additional lending to consolidate existing borrowing should be obliged to recommend that the potential borrower takes independent advice about the possibility of arranging repayment of existing debts without the need for additional borrowing. The recommendation to the borrower should be in writing. Alternatively advice could be given to consumers on the appropriateness of a consolidation loan through a leaflet to be published by the Office of Fair Trading. Failure to suggest that independent advice is taken or a copy of the leaflet provided prior to the provision of consolidated lending should mean that the consequent loan is unenforceable.**
- 5.12 In making this recommendation, the CAB Service is not suggesting that additional lending to consolidate existing borrowing is always poor practice. Many borrowers are attracted to such loans as a means of

reducing their monthly expenditure. However, although a new loan to consolidate existing debt does normally mean smaller payments, such payments are invariably over a much longer period (with a consequently higher total level of interest payments) and/or involve the repayment of unsecured debts with a loan secured on property (again with a higher total level of interest payments). Our concern is that consumers opting to take out a consolidation loan should be fully aware of the implications of the loan as well as alternative ways of repaying their existing borrowing.

- 5.13 We are particularly concerned at some of the evidence reported in Section 3 on loans secured on the home of the borrower. Much of this evidence again concerns debt consolidation. The decision to replace unsecured debts with a loan that puts the borrower's home at risk in the event of inability to maintain payments is one that should not be entered in to without very careful consideration on the part of the borrower. However, some impaired credit lenders seem more interested in the equity position of the borrower than the ability of the borrower to repay. Given that the consumer could lose their home if they fail to keep up repayments it is only right that lenders should be required to take special care about secured lending and face constraints if they fail to act responsibly.
- 5.14 **The CAB Service recommends that lenders who provide secured loans should not be able to repossess the home of a borrower unless the lender can prove that they took all reasonable steps to assess the borrower's ability to repay the loan. Such assessment should include the preparation of an income and expenditure report taking into account any identified or reasonably anticipated changes in the circumstances of the borrower during the term of the loan. The Office of Fair Trading should issue guidance as to the interpretation of 'all reasonable steps'**
- 5.15 In Annex One to this report we provide a brief overview of recent developments in the United States related to the problem of consumer debt. Recent legislation in some States has linked the ability of a consumer to repay a prospective loan with the percentage of that consumer's income being allocated to credit repayments. Creditors are obliged to ensure that the granting of a loan will result in not more than a specified percentage of a borrower's income being allocated to credit repayments. This is an interesting development that may be useful in determining when the use of credit spills over to being a debt problem. The CAB Service is not recommending that a percentage figure is forced on lenders in the United Kingdom, but we do think that it is an option that should be discussed in more detail. The establishment in November 2000 of a task force to consider the issue of overindebtedness in the United Kingdom provides the opportunity for this discussion.

5.16 The CAB Service recommends that the Task Force on Overindebtedness set up by the Government in November 2000 should consider whether additional lending to consumers should be restricted where more than a specified percentage of income will be allocated to debt repayments.

5.17 The CAB Service is also concerned at reports that some borrowers seem to be entering in to a cycle of replacing one impaired credit remortgage loan with another loan from an alternative impaired credit lender. The inevitable consequence of this is that the equity in the property of the borrower is reduced as a result of interest and remortgage costs. This is a well reported problem in the United States and whilst we have little direct evidence from CAB of it occurring in this country at present, we would urge policy makers and regulators to be vigilant. If evidence of this practice is reported in the United Kingdom, then we recommend immediate action to protect borrowers.

Provision of borrowing facilities for low income groups

5.18 It is important that any approach to the problem of extortionate credit addresses the financial exclusion experienced by low income consumers who cannot obtain credit easily or cheaply.

5.19 During 1999 and 2000 there have been significant policy initiatives led by the Government designed to understand and tackle financial exclusion. We are encouraged by recent initiatives in the development of basic bank accounts and the Government's move to promote credit unions. We urge those involved in this work to consider ways to ensure that lower income groups are able to get access to reasonably priced credit to help meet unanticipated or irregular spending.

5.20 Any argument that lower income groups should be provided with additional borrowing facilities runs the risk of the criticism that additional borrowing will lead to additional debt that cannot be repaid and fails to tackle the root causes of low income and poverty. The CAB Service is probably more aware of the problem of debt amongst lower income groups than any other organisation in the country. We are therefore very sensitive to the implications of the provision of additional borrowing. However, we still believe that alternatives to the high cost credit provided by the companies that do service lower income groups would be of overall benefit to those groups and to society as a whole.

5.21 We have previously noted that we would also like to see the major financial institutions taking a more positive approach to the issue of lending to the 'credit impaired'. The report of PAT 14²² is very helpful in this respect and we hope that lenders will take up the challenge of the options presented in that report.

²² Access to Financial Services, Report of Policy Action Team 14, HM Treasury (November 1999)

- 5.22 One way for people on very low incomes to be able to borrow at an affordable rate is through the Social Fund. A recent CAB evidence submission²³ has repeated the argument that it is essential that the Fund should provide grants and interest free loans to finance the essential needs of those eligible for help under the Social Fund. We take this opportunity to reiterate that argument and call on the Government to undertake the review of the Social Fund proposed within the PAT14 report.

Improving financial literacy

- 5.23 Many of the extortionate credit cases reported by CAB involve borrowers taking out high interest loans where there may well have been a lower interest rate loan that would have been available.
- 5.24 The increasing complexity of the UK consumer credit sector makes it difficult for uninformed consumers to evaluate and, if appropriate, take advantage of the opportunities offered by new credit products. For this reason, we consider it important that the problem of extortionate credit is also addressed through an improvement in the overall level of financial literacy.
- 5.25 Many CABs are already involved in local initiatives to enhance the levels of financial literacy in their area. We intend to report further on these initiatives early in 2001.

²³ Submission to the Social Fund Commissioner on CAB evidence on the April 1999 changes to the Social fund Scheme. April 2000

6. Recommendations

- 6.1 The CAB Service recommends that the Department of Trade and Industry seek views from interested parties, industry and consumers on all of the recommendations of the June 1999 report on extortionate credit from the Personal Finance Research Centre, The CAB Service further recommends that following consultation the Government should act to implement changes to the legislation without delay (paragraph 2.20).
- 6.2 The CAB Service recommends that section 138(1)(a) of the Consumer Credit Act 1974 is amended to provide that a credit agreement is extortionate if it requires payments that are excessive given the degree of risk taken by the lender in providing the loan (paragraph 4.13).
- 6.3 The CAB Service recommends that section 138(1)(b) of the Consumer Credit Act 1974 is amended to provide that a credit agreement is extortionate if it contravenes the ordinary principles of fair dealing (paragraph 4.14).
- 6.4 The CAB Service supports the early implementation of the Department of Trade and Industry's proposal that judges are allowed to consider whether a credit agreement is extortionate without the need for an application from the borrower (paragraph 4.24).
- 6.5 The CAB Service recommends that form N9A (form of reply where the debtor is not disputing that a debt is due but is seeking time to repay the amount claimed) is amended to include the question, 'Do you want any credit agreement that forms the basis for this claim to be referred to a judge for consideration of whether the agreement is extortionate?' If the answer to this question is 'yes', then the borrower should be asked to explain the reasons why the agreement is considered extortionate (paragraph 4.27).
- 6.6 The CAB Service recommends that form N11M (form of reply to mortgage possession claim) is amended to include the question, 'Do you want any credit agreement that forms the basis for this claim to be referred to a judge for consideration of whether the agreement is extortionate?' If the answer to this question is 'yes', then the borrower should be asked to explain the reasons why the agreement is considered extortionate (paragraph 4.28).
- 6.7 The CAB Service recommends that the current requirement for a claim for recovery of monies outstanding under a credit agreement to include a copy of the original credit agreement should be enhanced to require in addition a statement of all debits and credits applied to the loan agreement since inception (paragraph 4.31).
- 6.8 The CAB Service recommends that all claims for recovery of money lent under credit agreements include a fact sheet explaining the

legislation covering extortionate credit which includes examples of agreements and situations where a court may consider it appropriate to further investigate an allegation of extortionate credit (paragraph 4.32).

- 6.9 The CAB Service recommends that specified third party agencies such as Trading Standards Departments and the Office of Fair Trading be allowed to apply to the courts for consideration of whether an agreement is extortionate. It is in the public interest that extortionate credit bargains are tackled, so we also recommend that the costs of these actions should normally be met by the creditor where the court finds that the agreement is extortionate. In other cases costs should be met from public funds, unless the court is of the view that the application from the third party agency was vexatious or frivolous (paragraph 4.34).
- 6.10 The CAB Service recommends that the Office of Fair Trading collates and publishes information on average interest rates charged on different types of secured and unsecured credit agreements, and makes this available to both District Judges and the public. This information could also be used to improve the information available to borrowers before a credit agreement is entered into (paragraph 4.36).
- 6.11 The CAB Service recommends that a central record should be available to the public of all cases where the courts have considered the question of extortionate credit (paragraph 4.39).
- 6.12 The CAB Service recommends that any finding of extortionate credit should result in an obligation on the Office of Fair Trading to consider the fitness of the lender concerned to continue to hold a licence under the Consumer Credit Act 1974 (paragraph 4.40).
- 6.13 The CAB Service recommends that section 138(2)(a) of the Consumer Credit Act 1974 is amended to specify that the court is empowered to take in to account the interest rate charged over the whole term of the credit agreement in any determination of extortionate credit (paragraph 4.46).
- 6.14 The CAB Service recommends that borrowers should be allowed to seek the protection of the courts under the extortionate credit provisions for so long as the loan agreement continues (paragraph 4.51).
- 6.15 The CAB Service recommends that the Government withdraws the core term exclusion from the Unfair Terms in Consumer Contracts Regulations so that the rate of interest charged within a credit agreement can be considered under the Regulations (paragraph 4.62).
- 6.16 The CAB Service recommends that all credit agreements should be required to prominently show the total amount likely to be repayable by the borrower over the term of the agreement (paragraph 5.7).

- 6.17 The CAB Service recommends that credit agreements should be required to show the average interest rate for the particular type of loan along side the interest rate figure charged for the specific agreement being offered to the consumer (paragraph 5.9).
- 6.18 The CAB Service recommends that lenders providing additional lending to consolidate existing borrowing should be obliged to recommend that the potential borrower takes independent advice about the possibility of arranging repayment of existing debts without the need for additional borrowing. The recommendation to the borrower should be in writing. Alternatively advice could be given to consumers on the appropriateness of a consolidation loan through a leaflet to be published by the Office of Fair Trading. Failure to suggest that independent advice is taken or a copy of the leaflet provided prior to the provision of consolidated lending should mean that the consequent loan is unenforceable (paragraph 5.11).
- 6.19 The CAB Service recommends that lenders who provide secured loans should not be able to repossess the home of a borrower unless the lender can prove that they took all reasonable steps to assess the borrower's ability to repay the loan. Such assessment should include the preparation of an income and expenditure report taking into account any identified or reasonably anticipated changes in the circumstances of the borrower during the term of the loan. The Office of Fair Trading should issue guidance as to the interpretation of 'all reasonable steps' (paragraph 5.14).
- 6.20 The CAB Service recommends that the Task Force on Overindebtedness set up by the Government in November 2000 should consider whether additional lending to consumers should be restricted where more than a specified percentage of a borrower's income will be allocated to debt repayments (paragraph 5.16).

Annex One – Recent American experience

1. Consumers in the United States are the undoubted world leaders in the use of credit. Many of the new entrants to the UK consumer credit market in recent years have been American based and with them they have brought the new products and the innovative marketing and advertising techniques previously tested in the US market.
2. The lead of the Americans in this area does give us an opportunity to learn from the recent experiences of US consumers and possibly avoid some of the difficulties they have encountered.
3. The US has seen a significant increase in consumer debt over the past decade, mainly fuelled by the increase in consumer credit. The most recent (1998) Federal Reserve Board Survey of Consumer Finances reported that the proportion of American families whose debt payments represented more than 40% of their income was 12.7%. The corresponding figure in 1995 was 10.5%. The increase in overindebtedness was particularly marked in families with income of less than \$50,000 and in the 65+ age group.
4. The problem of overindebtedness is leading to legislation to better control lending practices. There is an increasing trend toward 'predatory lending legislation' to counter the excesses in the consumer credit market. Several states now have legislation in force, including California, New York, Minnesota, and Illinois. The legislation typically:
 - prescribes a requirement that lending must have regard for the repayment ability of the borrower (assessed by a percentage comparison of debt repayments to gross income);
 - prohibits the 'flipping' of loans ('flipping' means refinancing an existing loan where the new loan does not have a reasonable tangible net benefit to the borrower considering all of the circumstances, including the terms of the new and the refinanced loan, the cost of the loan, and the borrower's circumstances);
 - prohibits any encouragement or recommendation that the borrower should default on an existing loan; and
 - requires that credit counselling is required before some loans are advanced.
5. Earlier this year, the 'Anti-Predatory Lending Act of 2000' and the Consumer Mortgage Protection Act of 2000' were laid before Congress. The aim of the first bill is self-explanatory from its title; the purpose of the second bill is to address the abusive lending practices within the US mortgage industry – particularly from sub-prime lenders – and provide protection for vulnerable consumers.

6. Consumer groups in the US are reporting on-going concerns around many activities in the consumer credit sector. However, there is particular concern about equity (secured) lending from impaired credit lenders.
7. Two relatively new developments in the US impaired credit market are causing the most concern for consumer groups. The first is the 'no-equity loan', otherwise known as the 125 percent LTV (loan to value). The second is the home equity secured credit card.
8. The 'no-equity' loan first appeared on the US market in 1995. No equity loans allow borrowers to borrow up to 125% of the value of their home – although some US companies have been reported to offer loans of up to 150% of the home value. They are generally marketed to those in debt as a means of consolidating high interest credit card and other unsecured debt into a single mortgage payment at a lower interest rate.
9. As we have confirmed in the main body of this report, a consolidation loan may be an option for an indebted borrower to pursue. However, the experience of US consumer groups is that, more often than not, debt consolidation leads to even more debt. Where the consolidation loan is secured against property in a way that extinguishes all equity in the property, there is a real risk that the borrower will face the loss of the home.
10. In the summer of 2000 we have started to receive reports from CAB money advisers that no-equity loans are being introduced to the UK market. This development is not unexpected given the impact they have had in the US, but we are concerned at the possible impact on ill informed and vulnerable UK consumers.
11. Home equity secured credit cards are described by the US Consumers Union as 'one of the most perilous products to emerge from the subprime lending industry'.²⁴ All purchases made on the credit card are secured on the borrower's home. Because the loan is secured and the lender has the ultimate option of repossession in order to get their money back, the credit rating of the borrower can be less than perfect. However, like the vast majority of credit cards, any long term borrowing on the secured credit card is expensive with interest rates being far higher than a normal mortgage. However, in a society that is increasingly exhibiting a 'buy now, pay later' mentality, US borrowers who find their access to more mainstream forms of credit blocked are being tempted by this product.
12. To date, we have no reports of the home equity secured credit cards gaining a foothold in the UK. However, the same principle of providing a revolving credit facility secured on the home of the borrower is provided by some of the flexible mortgage products now being heavily

²⁴ Consumers Union: The Hard Sell: Combating Home Equity Lending Fraud in California (1998)

promoted in the UK. These allow borrowers to use their mortgage account as a current account and effectively access an automatic overdraft facility linked to a percentage value of their property. Such products – which are not part of the UK impaired credit sector – can be an efficient way for an informed and strong willed borrower to minimise the overall cost of their mortgage through accelerated repayment. However, there is a potential danger that an unwary or uninformed borrower may not clear the loan over an accelerated period or even over the originally anticipated repayment period. Whilst we have as yet received no evidence reports from CABx concerning this issue, the American experience of using home equity to access an on-going credit facility should put the UK authorities on guard.

List of CABx which submitted evidence

Abingdon	Keighly	Tonbridge Wells
Addington	Kingston	Uxbridge/Hillingdon
Alnwick & District	Leeds City Centre	Wakefield
Barnsley & District	Leigh & District	Wallasey
Barrow In Furness	Leigh Park	Warrington
Bicester	Leiston & Saxmundham	Warwick District
Blackburn	Luton	Wearside MAU
Bracknell	Lymington	Wigan
Bradford	Maidstone	Winchester
Brighton & Hove	Melton Mowbray	Witham
Burnley	Merton MAS	Woolwich
Burton-On Trent	Middleton	Worthing
CALL	Millom & District	Wrexham
Camden CAB HIV	Mitcham	Wymondham, Attleborough & District
Cardiff Central	Newham	
Carmarthen	North Kirklees	
Chepstow	Northwich	
Chesham	Nottingham	
Chester	Oldham	
Colwyn Bay	Penrith	
Crawley	Peterborough	
Daventry	Peterborough & District	
Denbigh	Putney & Roehampton	
Derby	Reading	
Dorking	Redcar & Cleveland	
Elstree & Borehamwood	Redditch	
Ely	Redhill	
Farnborough	Richmond	
Gloucester	Scarborough & District	
Gloucester MAS	Sheen	
Gravesham	Sheffield Debt Support	
Greenwich MAS	Shoreham	
Guildford	Skipton	
Harborough District	Southampton	
Harlow	Southend On Sea	
Haverfordwest	St Helens District	
Haverhill	Stevenage	
Hazel Grove	Stockport	
Hebden Bridge	Stone	
Henley & District	Swansea	
Herne Bay	Swindon	
Heswell	Sydenham	
Hillingdon	Tonbridge	
Hyndburn	Torquay	