Consumer Finance Association

Email: John.Lamidey@cfa-uk.co.uk
Telephone: +44 [0]1244 505545
Mobile: +44 [0]7973 129077

'WOULD YOU CREDIT IT?'
HOW TOO MUCH REGULATION CAN BE BAD FOR YOUR FINANCIAL HEALTH

Access to consumer credit is a major issue – not specifically for those on low incomes (since the Government made £98,750,000 available in a growth fund to be loaned by credit unions between June 2006 and March 2009); but more particularly for middle and lower middle income consumers. Banks are retrenching on lending in response to current markets and a rapidly developing risk-averse culture. As a result, consumers are finding it more difficult to borrow from mainstream lenders.

It is extremely important during these uncertain economic times that regulation is proportionate and balanced in such a way that consumers are adequately protected, but not unnecessarily over-protected; that industry is not burdened with unnecessary regulation and the resultant costs arising, and that the objectives of Government in stimulating lending are met.

Regulatory change favours running account credit or bank overdrafts that allow customers to repay what they like, when they like, with no real incentive to pay more than the bare minimum. Doing so leaves an individual with a clean credit record even though there may be significant levels of debt. However, personal loans demand repayment in full, on time, or an adverse credit record will occur – reducing the chances of access to further credit.

A balanced approach is the discipline of regular repayments of a personal loan, but with flexibility to cater for some fluctuation. But both UK and EU legislation skew the market to give easier access to running account credit (such as credit cards) and bank overdrafts (both authorised and unauthorised) at the expense of the more controlled lending on fixed term contracts.

The net result of some regulatory proposals will be that far fewer people will be able to obtain consumer credit, whilst those that do will have to pay higher prices. Lengthy and intrusive application processes will discourage switching; both lenders and borrowers will opt for running account credit as the bureaucracy and difficulty of obtaining fixed term credit is increased and those with established lines of credit will stay with a provider come what may. It is also anticipated that there will be a significant rise in “authorised users” of credit cards when friends and family members cannot get credit and seek to be included on another person’s existing credit card. The results of this could be socially divisive in the medium term.

The regulatory issues arising need to be considered carefully in the context of their potential to create even further financial exclusion for consumers. If lending criteria become too prescriptive due to regulatory guidance, in excess of 10 million people could be denied access to consumer credit, although many of these would still be credit worthy. This is equivalent to about 1 in 4 consumers of working age (and over the age of 18) being unable to access suitable forms of consumer credit.

Many individuals rely on access to credit to smooth the peaks and troughs of income and expenditure. Reducing significantly consumer access to small sum, short term loans would *increase* debt in non credit areas such as utility bills, council tax, income tax and N.I. payments - particularly by the self employed, who comprise 13.2% of the total employed population.

An over-reliance on bank overdrafts is a real possibility. Kempson and Atkinson found that in respect of current accounts, 14% were overdrawn but didn't know how regularly, 12% were sometimes overdrawn and 10% were virtually always overdrawn [Kempson E and Atkinson A (2006) *Overstretched: People at risk of financial difficulties*]. This situation will only be exacerbated if quick access to small, short term funding is restricted only to bank account overdrafts.

On 18th September 2009 *The Daily Mail* published a story asserting that: *Millions of bank customers will see their overdraft charges slashed as another high street name cuts its fees.* One bank *will instead introduce a daily penalty of £5 for those who go in to the red*. £5 a day for an unauthorised overdraft is £150 of charges in a 30 day month. Go into unauthorised overdraft by £200 for a 30 day month and pay £150 for the privilege - that's 75% interest for the month, the APR is 82,400.5%. When an individual goes into unauthorised overdraft it may be several months before they are able to return to a positive balance situation. But even if a £200 unauthorised overdraft situation lasted only 20 days, at a £5 a day charge, the total charges would be £100 - 50% interest for 20 days – an APR of 164,286.6%.

There is a rapidly growing requirement for responsible, small sum short term lending that is based on flexibility and a full understanding of the individual's *current* outgoings and commitments. Post credit crunch, flexible small sum, short term finance products are essential for the needs of a growing number of consumers, to promote financial inclusion for everyone, not just those on low incomes. Regulatory moves towards prescriptive lending criteria, where lenders are branded as irresponsible if they lend to any but the safest customers, will damage consumers.

With £1.4 trillion consumer debt, one cannot simply turn off the supply of credit and tell people to live within their means. Living within one's means may be all well and good, sound prudent and appear wise advice to consumers, but the £1.4 trillion debt still has to be managed and serviced. Only 60% of consumer credit is supplied by the banks. The 40% supplied by non-banks has not required any Government support. These lenders make their risk assessments and bear the costs of any mistakes they make. They are no danger to the taxpayer, the Government or the banking system. They are, however, a significant benefit to hard pressed consumers.

Small sum, short term finance should be actively encouraged so that consumers who do have impaired credit histories can be rehabilitated by establishing a favourable repayment record. The credit crunch is impacting on people who are unable to switch lenders or consolidate their debts for a more favourable deal. Former access to easy credit means that those consumers who have multiple debts are now unable to refinance and switch to better deals because of liquidity issues and tightened credit scores. Currently 1 in 4 people are excluded from mainstream credit but this will rise as the credit crunch impacts both middle and lower income consumers. The outcome will be greater financial exclusion across all socio-economic groups.

The Consumer Finance Association supports appropriate, balanced and above all flexible regulation that recognises the needs of both consumers and industry. We promote the work of money advice charities such as Credit Action, the Consumer Credit Counselling Service (CCCS), and National Debtline, that assist people in financial difficulty.