CONSUMER PROTECTION CODE
CONSULTATION PAPER CP33

RESPONSE BY CONSUMER CREDIT ASSOCIATION
REPUBLIC OF IRELAND

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CCARI, Westgate,

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Contents

CONSUMER CREDIT ASSOCIATION, REPUBLIC OF IRELAND

The Consumer Credit Association Republic of Ireland (‘CCARI’) represents home credit. CCARI very much welcomes the chance to comment on CP33.

Home credit offers its customers small, unsecured loans, repaid weekly. These are short-term credits ranging in length from about 26 weeks to about 52 weeks. The sums lent are typically in the range of €200 to €700.

Each week, the lender’s agent will visit the customer to collect repayments and, where required, issue further credit. Relationships between agents and customers are very good and this is at the heart of the success of the business.

Home credit is a simple product. Charges are ‘all-in’, with fixed interest and no extra costs for missed or part payments. This simplicity means the product is also very transparent.

There are very few customer complaints about home credit.

EXECUTIVE SUMMARY

The arguments we made in 2005 about CP10 apply equally to CP33. CP33 will impose a disproportionate burden that will harm consumers[1]. Unwelcome side effects are likely to include upward pressure on prices, reduced competition (as firms exit), reduced access to credit and reduced availability of smaller loans. **Our central theme is that CP33 runs completely counter to the Government's promise[2] to 'regulate better'**. For example:

- **there is no obvious rationale for CP33**. FR's 2007 study[3] revealed a sector that was popular with customers. They expressed positive views of both the service and the lenders. Less than 5% of customers were experiencing any real problems. Those that were had mainly experienced unpredictable life events such as job loss or benefit changes. CP33 cannot 'protect' these customers in any way.

- **'better regulation' calls for new regulations to have a clearly defined objective or target**. We have struggled to see what problem CP33 is supposed to address.

- **timings in the FR's Strategic Plan raise other 'better regulation' issues**. The Plan states that CPC should be imposed on moneylenders by December 2008. Yet only months later (*'early 2009'*) the entire CPC is to be reviewed. It is wholly unreasonable to impose new rules on lenders when it is clear that a review of those rules will follow almost straightaway. Such an approach cannot be in line with 'better regulation' principles.

- **CP33 fails to factor in the pending Consumer Credit Directive** ('CCD'). It is almost certain that parts of CCD will cut across the CPC. In fact, the hostile lending environment that CPC creates will damp down (not boost) the cross-border credit activity hoped for by the Commission. The CPC regime is likely to both deter new market entrants and also to drive existing businesses out of Ireland[4].

- **overall, CP33 will impose a costly and disproportionate new bureaucracy**. This will have the unintended outcomes we describe above, namely, upward pressure on prices; reduced competition (as firms exit); reduced access to credit (financial exclusion) and reduced access to smaller loans (financial exclusion). Illegal lending would also increase.

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[1] Our key concerns with the current text in this context are on **advice** (§2); **knowing the customer** (§11, 12, 15); **suitability** (§16, 17); **unsolicited contact** (§18, 19, 21) and **general record making and keeping**.

[2] See '*Regulating Better*', Government White Paper, January 2004.

[3] See '*A Report on the Licensed Moneylending Industry*', March 2007 at p.4.

[4] An article in Sunday Business Post online for 27 April 2008 commented that: *'The markets for credit cards, current accounts and term loans have become less competitive since the Financial Regulator was set up five years ago. Figures…in the Regulator's annual report…show that between 2002 and 2007 all markets analysed* [except residential mortgages] *became increasingly uncompetitive.*

OUR 2005 CP10 SUBMISSION

We responded in detail to the FR's 2005 CP10 consultation.

Many of the comments we made on that occasion continue to be relevant in the context of CP33.

We therefore ask FR to treat this response to CP33 as including all the comments we made in our 2005 submission, except to the extent that the concerns we expressed then have been fully satisfied by relevant modifications to the proposed code for moneylenders.

We can supply a further copy of our response to CP10 if required, but we assume FR will have it on file.

APPARENT MISCONCEPTIONS IN 2007 STUDY

The FR's 2007 study into moneylending[5] ('the 2007 study') promised to:

> *'…review the current Interim Code of Practice…with a specific emphasis on increasing transparency, helping consumers make informed decisions and enhancing the consumer protection framework'.*

In isolation, these are valid and worthy objectives. However, we think the 2007 study has come to incorrect conclusions about market failure. It may also be (erroneously) thought that CP33 will in some way correct this perceived failure.

The 2007 study made two observations:

- first, most home credit users *'…did not compare interest rates…'* and *'…did not know the rate being charged…'*[6]
- second, that *'There appears to be little conformity between moneylenders as to what the market determined APR is for a certain size loan over a certain period.'*[7]

This seems to have pushed the study towards the view that there was some kind of market failure:

> *'In a competitive market for a straightforward product such as a loan, one would expect to see this development* [i.e. rate convergence]. *Given the relatively high rates when compared to other credit providers, one would expect, in a competitively functioning market open to new entrants and numerous providers of credit, that the APR would be reduced. In the context of the APR charged by moneylenders, competitive forces appear to be breaking down and are failing to drive down the rates charged'.*[8]

We strongly disagree with this reasoning. There is much more to this than meets the eye. In particular, the UK Competition Commission[9] ('UKCC') reached the view that APR was a very poor measure of the cost of home credit.

On the next two pages we review these issues in more detail.

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[5] *'A Report on the Licensed Moneylending Industry'*, ibid.
[6] Pages 5 and 12
[7] Page 12
[8] Page 12
[9] See the UK Competition Commission inquiry into home credit. This was carried out over the period 2004-2006. Three key reports were published, namely Emerging Thinking, Provisional Findings and Final Report. Much of the discussion on APR is to be found in the first two of these reports.

APPARENT MISCONCEPTION: USERS FAIL TO COMPARE RATES

The theory is that APR should drive credit choices; if not, the market has 'failed'. For home credit, this theory falls apart. These are the reasons why:

- the 1995 Act[10] purposely aimed to split collection charges out of APR. So home credit APRs (in Ireland) will tend to have almost no link at all with the real cash cost.

- the UK Competition Commission ('UKCC') reached the very firm view that APR was *'…a poor measure of the cost of a home credit loan…'* (in the UK, APR must include collection charges). UKCC said:

  > *However, lenders have told us, and we agree, that the APR has significant limitations not only for comparing different credit products but also for comparing home credit loans of different lengths (see Appendix 3.1). APRs, especially for shorter-term home credit loans, can be very high.* ***We do not consider that the APR is a useful comparator for customers, when it is at such high levels. With APRs above 100 per cent, customers may be able to tell that a particular APR is greater than another, but the APR conveys little further useful information****'*. [our emphasis]

- UKCC also had key views on home credit's special features. UKCC said it could be quite rational for someone on a tight budget to use home credit (even though it would cost more). We see this as non-price competition at work. UKCC put it this way:

  > *'3.28. However, this does not mean that where the customer has the choice of other products it would always be rational to take the lower-priced product. The characteristics of home credit (notably home collection, the facility to miss payments without penalty and the absence of hidden charges) are very different from those of any other credit product, and may be of considerable value to some customers. For example, we consider that it would be rational for a customer who expects to have an uneven repayment record not to choose a product which imposes charges for missed or irregular payments. A customer who does so and suffers unexpected penalty charges is unlikely to do so more than once, given alternative options. We further consider that people living on limited budgets have a strong incentive to avoid the risk of unexpected additional calls on their weekly budget…'*

This all means that whether or not a home credit user knows the APR is irrelevant. Even if he does, it tells him nothing useful. The 2007 study rightly identified that customers do know what their weekly payments are[11]. Evidence to the UKCC by Professor Kempson echoes this, and highlights the customers' acute sense of what they are paying:

> ***'Just about every home credit customer we have ever interviewed knows the total cost of borrowing - unlike the generality of credit users.*** *They do not know the APR on their loan and nor can they easily compare costs from different lenders. But work we are currently undertaking for the Financial Services Authority for a base-line survey of financial capability shows that this is true of the great majority of credit users too.* [our emphasis]

[10] Consumer Credit Act 1995
[11] Pages 5 and 12

APPARENT MISCONCEPTION: HOME CREDIT PRICES DIVERGE

The 2007 study said that *'there appears to be little conformity between moneylenders as to what the market determined APR is for a certain size loan over a certain period.'*

We were very surprised to read this. Until 1995, the Moneylenders Act 1933 in effect controlled home credit prices. As a result prices had 'bunched' (as economic theory predicts). We are not aware that prices have changed much since then, as *de facto* price controls have also been operated for much of the period since 1995.

So we are not sure what data FR used to reach this price divergence conclusion.

However, if *the register* alone was to be used, no firm conclusions about divergence could be drawn. This is because the register:

- includes lenders who do **not offer a home collection** service[12]
- shows APRs that **may not include the collection** cost[13]
- only **shows the highest APR** that the member charges[14]
- does **not show minimum loan size**[15]
- does not reveal **how much of the lender's 'book' is on those terms**[16]
- does not show **the size of the lender**[17]
- may include lenders who offer home collection but **who also have large office 'books'**[18]
- does not show **whether the transaction is for goods or cash**[19]

We urge FR to 'reality check' its conclusions on price divergence against the factors listed. Any of the above could explain price differences[20].

[12] 'Remote' lenders' cost structures are quite different to those of a pure home credit lender.
[13] As specified by the 1995 Act.
[14] The lender's shortest-term product (likely to have the highest APR) may only be granted to the very best customers. Or it may be a product that is just not used much and so does not carry a 'market' price.
[15] If lender A charges 180 APR over 25 weeks and lender B charges 170 APR over 25 weeks, the products cannot really be compared if lender B's minimum loan is €500 whilst lender A's minimum loan is €200.
[16] A lender's register entry may show a short-term product that the lender is only willing to offer to a small number of customers. The lender's **main** product may be a longer-term loan.
[17] A small lender with 200 hand-picked customers is likely to have a lower bad debt charge than a large operator with 20,000 customers. This may enable the small lender to undercut the larger player on charge per € lent.
[18] Such a lender may have a completely different cost structure to a player most of whose business is home collected.
[19] Where goods are supplied on credit (retail credit), all or part of the credit charge can be assimilated into the price of the goods.
[20] And APR disparities that *seem* wide may represent only minor *cash cost* differences.

CONCEPT 1 - BUREAUCRACY CREATES DEADWEIGHT COST

The Government's 2004 White Paper, *'Regulating Better'* ('the 2004 White Paper'), spells out the economic impact of regulation for business:

> *'It is important to recognise that there are costs associated with regulation. Direct costs include fiscal costs (e.g. the cost to the Exchequer of administrators' and legislators' time, the cost of enforcement, etc.). Direct costs also include the cost to industry, business or citizens of complying with the regulations - e.g. installing new equipment, meeting new standards, etc. It is critically important for competitiveness and for social equity that we know what the direct costs arising from a regulation would be and who will bear them.*[21]

These comments echo earlier remarks from the US Joint Economic Committee of the Senate and the House[22]:

> *'Regulations work like taxes. It makes no difference to the entrepreneur, or the economy, whether the entrepreneur must write a $5,000 check to the government for taxes or a $5,000 check to comply with a regulation. Forcing the entrepreneur to comply with regulations diverts resources to less-productive uses. Unwise regulations destroy wealth as it diverts resources, labor and capital, into unwanted uses*
>
> *Economic growth is created by entrepreneurs efficiently providing goods and services to their consumers. Regulations interfere with the basic process of production. Furthermore, the economic well-being of consumers is maximized by satisfying their wants at the lowest possible costs. Regulations raise costs and hinder entrepreneurs from supplying many consumer goods. Higher costs slow economic growth. The slow down in economic growth reduces incomes and makes everyone poorer.'*

This deadweight cost needs to be taken into account when considering what the potential benefits of CP33 may be. As the 2004 White Paper puts it:

> *'**Proportionality**: are we satisfied that the advantages outweigh the disadvantages of the regulation? Is there a smarter way of achieving the same goal?*[23]

[21] *'Regulating Better'*, p.21
[22] One of four standing joint committes of the US Congress. Report dated June 1996.
[23] *'Regulating Better'*, p.2

CONCEPT 2 - DEADWEIGHT COSTS HAVE GREATER IMPACT ON SMALL LOANS

With a few exceptions, home credit businesses are fairly small. They are also making very small (micro) loans.

This all impacts on the cost of regulation. The 2004 White Paper explains how regulatory costs can tend to bear down more harshly on smaller firms:

> *'…compliance can place a disproportionately higher burden on smaller firms. It was estimated by another EU Member State in 1995 that the cost of 'red tape' absorbed by small business works out at €3,600 per annum for each person employed. For larger firms, the comparable figure was put at €153. In…SMEs…administrative compliance is not easily delegated or contracted out. Excessive compliance requirements…that are insensitive to the…difficulties of SMEs, will deter new entrepreneurs.'*[24]

Again, the US Joint Economic Committee has said much the same thing:

> *'The costs of regulation are not evenly spread over the population. Many businesses suffer excessively from…regulations. In a study by Dr. Hopkins, he estimated that small – and mid-sized businesses suffer disproportionately. He estimated that businesses that employ more than 500 workers pay on average $2,921 per employee to comply…businesses with fewer than 20 employees pay $5,545 to comply .'*[25]

<u>Small loan size compounds these effects still further</u>. Take, for example, two loans. One is a bank loan for €8,000, the other a €400 home credit loan. Para.11 of CP33 requires the lender to 'gather and record' information. Such a process is likely to cost much the same amount whether the loan is for €400 or €20,000.

Assume that the cost is €15[26]. As a 'flat' percentage of an €8,000 loan, this is 0.18%. As a 'flat' percentage of a €400 loan, this is 3.75%. The table shows how factoring in this extra cost would impact on APR for loans of €8,000, €400 and €200[27]:

Loan	Term	APR (unadjusted)	New APR (adding in €15)
€8,000	36 months	8.8%	8.9%
€400	51 weeks	150.3%	164.7%
€200	26 weeks	187.7%	263.5%

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[24] *'Regulating Better'*, p.21
[25] Report dated June 1996
[26] This may not be the actual cost, which could be higher or lower, but is a figure taken for illustrative purposes.
[27] These APRs aim merely to illustrate just how significant the cost impact would be. Whether a lender could in fact increase charges by these amounts would depend on market forces and conditions.

CONCEPT 3 - DEADWEIGHT COST CAUSES CONSUMER HARM

There are limits to the costs that any business can absorb and all traders look for ways to mitigate their impact.

An obvious market response to new regulatory costs is to try to increase prices. This is especially true of non-credit markets[28].

But lenders have other options as well. This is because they have a product (credit) that can be reconfigured. For example, lenders can:

- **turn down more higher-risk customers**, shrinking the business but reducing bad debt.
- **increase the minimum loan they offer**. This saves on administration, because smaller loans cost more per € lent.
- **stretch their loan terms.** Again this saves on administration because - over a given period - each customer takes fewer loans.

When a lender takes one of these steps, **choice and access for consumers reduces**. This is consumer detriment at work.

So, for example, a turned-down customer is a financially excluded customer.

And consider too a customer who once used to borrow €250 (because that was all he needed). He now finds that the smallest loan on offer is €500. The result is he now faces a greater risk of debt problems (because if he wants credit he will have to borrow more than he needs).

So in all these ways (increased prices; reduced access; reduced choice) the cost of regulation can cause direct harm to the consumer of credit.

[28] We believe this is now observable in the UK market. Here, there is mounting evidence of rising credit charges as lenders adjust to a raft of new rules, laws and court cases.

CONCEPT 4 - CREATING FINANCIAL EXCLUSION

Financial exclusion is a matter of serious public concern. In the 2007 study, the FR says:

> *'Not all consumers have access to other sources of credit. The Combat Poverty Agency has recently completed research on the area of financial inclusion and the Financial Regulator is considering the policy implications on foot of that research. We also working with relevant agencies* . [page 15]

Curiously, the draft code in CP33 also obliquely mentions financial inclusion, in the following terms:

> *'A moneylender must ensure that…it…does not, through its policies procedures or working practices, prevent access to basic financial services;…'* [page 15]

The irony is that **CP33 will itself cause financial exclusion**. We explain elsewhere how the cost of the new CP33 bureaucracy is likely to have two key effects. Some traders will exit the market. Those that remain will increasingly reject new applicants for credit (for the various reasons explained elsewhere).

This will set in train a process of exclusion. Consumers who are rejected by home credit lenders are unlikely to get credit elsewhere.[29] This is because weekly home collection enables home credit lenders to successfully lend to higher credit risks. In other words, if a home credit trader is unwilling to lend, it is reasonable to assume that most 'mainstream' lenders (including credit unions) will not either.

There is a postscript to this. These rejected customers will be able to tap into one source that is unaffected by CPC. This is the illegal market for credit, which we discuss next.

On reading CP33, it is clear that some of the original respondents to CP10 assumed that CPC could be imposed on the home credit sector without any reduction in access to this form of credit[30]. This assumption ignores simple economic principles and is very seriously mistaken.

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[29] Except from illegal sources - see later.

[30] CP33, page 1: '*While it was stated that customers of moneylenders should have the same level of protection as other borrowers, it was also stated that whatever provisions maybe introduced should not restrict a person's access to this form of credit'.*

CONCEPT 5 - EXACERBATING ILLEGAL LENDING

When we responded in 2005 to CP10, we raised the question of illegal lending. We explained that if CPC was imposed on home credit, this would almost certainly lead to increased illegal lending in Ireland. We believe this also holds true for CP33.

Since we responded on CP10, there has been a key development. The UK DTI (now BERR) has conducted its own research into illegal lending in the UK. The work was carried out by POLICIS/PFRC and their report[31] was published in November 2006. This was the first ever empirical attempt to scope this problem. POLICIS/PFRC used a range of techniques, including saturation surveys. Their study focused on individuals with the lowest 20% of incomes.

The report made grim and thought-provoking reading. Key conclusions were these:

- about 165,000 UK households were using illegals (0.44% of the adult UK population)[32].
- POLICIS/PFRC UK surveys suggest that those turned down by a home credit lender are five times more likely to use an illegal lender…
- …so there is now a **provable correlation between access to products such as home credit** (or rather lack of access) **and the incidence of illegal lending**. **Putting this another way, the POLICIS/PFRC surveys tended to show that home credit keeps illegal lending in check**. There are other examples too. Other POLICIS survey work has revealed that price control laws in France and Germany (which restrict credit supply) have created illegal credit markets two or three times the size of the illegal UK market.

The POLICIS report points out that increased regulatory pressures on the home credit sector are likely to exacerbate the illegal lending problem[33]. A key conclusion reads:

> *'…given the difficulties inherent in the detection and enforcement of illegal lending and the significant challenges and costs associated with creating alternative sources of social credit, the most effective strategy for combating illegal lending would appear to be the maintenance of a regulatory environment which encourages legal credit options'* . [page 89]

Given the similarities between Ireland and the UK, it is reasonable to suppose that things (in relation to illegal lending) are probably much the same in both countries.

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[31] *'Illegal lending in the UK - research report'*, November 2006, POLICIS and Personal Finance Research Centre

[32] The report states that *'in no sense are illegal lenders simply unlicensed versions of high cost lenders'* and also notes that this is a phenomenon that is *'…deeply damaging to victims and communities'* [p.9].

[33] See, for example, page 9.

CONCEPT 6 - CREATING NEW LEGAL RISKS FOR LENDERS

Judging the normal commercial risk of not being repaid is what lenders do. Huge resource is devoted to assessing that risk. **<u>The effect of CPC is to create a second new, parallel risk</u>**. This is the risk that a consumer will, in effect, claim against the lender based on breach of CPC.

The consumer could claim on various bases. For example, he could argue that the lender had 'not acted in his best interests' (General Principle 1); that he had 'not been properly advised' (§2); that 'insufficient information had been gathered' (§11, 12) or that the loan was 'not suitable' (§16, 17). **<u>This artificially-created risk (that derives purely from CPC) is entirely distinct from the risk of not being repaid</u>**.

It is important to grasp that this is an extra and separate risk. **<u>It has nothing to do with whether or not the consumer would be likely to repay</u>**. Instead, it is a risk that is to do with the consumer's propensity to claim against the lender based on CPC.

For many consumers, this will create an unhelpful outcome. On a **<u>commercial assessment</u>**, a customer might be deemed able to repay. However, on the **<u>assessment of CPC risk</u>**, his propensity to claim may be judged too high **<u>and he will be rejected on this CPC risk basis</u>**.

This analysis all sounds odd, but that is because CPC is very recent and credit markets still have to adjust. It is worth pointing out that in the US, just such a parallel risk emerged in relation to bankruptcy. To deal with it, US lenders have, for some time, had access to what are called 'bankruptcy risk scores'. These measure <u>propensity</u> to file for bankruptcy:

> *'You probably already know about your credit score. That's the number that helped increase your credit card limit or perhaps prevented you from purchasing your dream car. Well, there's another influential scoring tool you should know about: it's called the bankruptcy risk score. According to financial experts, this score is used secondarily to the credit score when financial institutions scrutinize a consumer's credit history. Kept tucked away from consumers for nearly 20 years, this number differs from the credit risk score, because it's a little more specific. It measures how likely a person is to file for bankruptcy.'*[34]

Just as a 'bankruptcy risk score' could lead to an applicant (who could repay) being refused, so a 'CPC claim risk score' could also lead to applicants (who could repay) being turned down.

[34] Excerpt from MSN Money site.

WHAT WILL CP33 DO TO HOME CREDIT?

At one level, CP33 appears innocuous. It appears as though the key concepts ('acting in the best interests of the customer', 'assisting the customer', 'knowing the customer' and 'suitability') are the sorts of things *'that a good lender would do anyway'*.

In a **loose**, **non-legal** sense, a well-run credit company will be doing much of this for a fair proportion of its customers (and other customers will not want this done). The problem is that FR will require lenders to **prove** that they have done all these things for all customers (Rules 39 and 42). This in turn calls for complex and detailed data gathering and record keeping.

It is one thing to generally act in a decent and responsible way. It is quite another to have to set up and run systems to 'prove' this for each and every customer. **This is a complete and fundamental change in the way the home credit sector has to function** (and may be an equally seismic change for other industry sectors).

In truth, no home credit lenders have systems that can currently do any of this. So CP33 implies business reconfiguration at every level, including:

- more intrusive and detailed questioning of customers
- the creation of new paper and computer systems to handle the resulting mass of data
- systems to audit all these processes

The cost of all this would be extraordinary.

The policy thrust of CP33 might be more clear-cut if the FR research had revealed a sector with clear and obvious problems. But this is emphatically not the picture the 2007 study paints. **This is why we believe that CP33 runs counter to 'better regulation' principles**.

In this general context, we are curious as to how the rest of the credit industry achieves compliance. We could see that in many respects, they would experience many of the same problems as us. The one difference is that, as we explain later, we have much more serious proportionality issues. This because of the small size of our loans, the frequency with which customers take out new loans and the frequency (weekly) of our contacts with customers.

IDENTIFYING THE KEY AREAS OF CONCERN

CCARI's **primary concern is with the extraordinary new bureaucracy** required to meet the **proof** and **recording** requirements of:

- the need to 'act in the best interests of customers' (if indeed this is possible to do: see later)[35]
- the need to 'assist the customer' in understanding the product[36]
- the need to 'know the customer'[37]
- the 'suitability' rules[38]
- the 'unsolicited contact' rules[39]
- the default notification rule[40]

CCARI also have very serious concerns about what would, in fact, be required to:

- 'act in the best interests of customers'
- 'assist the customer to understand the product'
- 'know the customer'
- 'ensure a product is suitable'

[35] General principle 1
[36] Rule 2
[37] Rules 11,12, 13, 14 and 15
[38] Rules 16 and 17
[39] Rules 18, 19, 21
[40] Rule 34

CONCEPT CRITIQUE - 'ACT IN THE BEST INTERESTS OF CUSTOMERS'

We have real fears that - in *technical* terms - this concept cannot be squared with the normal functioning of a credit market[41].

We imagine that the phrase originated in the context of investment rules. We can see that investment actions taken on behalf of the customer should be effected *'in the best interests of the customer'.*

However, in the case of a *consumer credit* market, the concept is, we believe, unworkable. Taken to its logical conclusion it might, for example, require the lender to take no profit from the transaction or to tell the customer what prices other lenders are offering.

Modern credit markets do not (and cannot) work in this way. Instead they can only work on the basis of honest and fair disclosure by lenders of costs and terms, with the consumer taking responsibility for choosing the product he requires.

[41] As compared with, for example, decisions made on behalf of the consumer when investing funds. It is also worth stressing that *'acting in the best interests of customers'* is different from concepts such as *'treating customers fairly'*.

CONCEPT CRITIQUE - 'ASSIST THE CUSTOMER IN UNDERSTANDING THE PRODUCT'

We are unclear what the detail of this proposition is supposed to involve.

We had always understood that the aim of the 1995 Act was to ensure that the paper contract issued to the customer should disclose all the relevant express terms and conditions.

Again, we can see that a concept as set out in Rule 2 might be highly appropriate in the context of a high-value, high-complexity investment transaction.

However, in the context of straightforward consumer credit, this seems to be disproportionate (and so contrary to principles of 'better regulation').

CONCEPT CRITIQUE - 'KNOWING THE CUSTOMER'

Again, this is a concept that makes total sense for investment or insurance products. This is because the way those products will eventually work for the consumer will depend very much on the consumer's personal circumstances.

There is also a conflict of interest for these types of product; if they work 'badly' for the consumer, they in fact work 'well' for the supplier.

By contrast, for credit, **the interests of lender and customer are in fact aligned**. Both the lender and the customer are concerned to ensure that the product 'works well' (i.e. is repaid).

Lenders therefore already expend a great deal of resource and effort in trying to ensure that the loans they grant have a reasonable chance of being repaid (and they do not make loans they think have a good chance of failing).

The problem is that the techniques used to achieve this outcome do not necessarily involve 'knowing the customer' in the way CP33 envisages. In fact, a vibrant and thriving credit market allows lenders to experiment and find the techniques that work best for them. The variety of techniques is immense and infinitely varied. Such techniques may involve intuition (based on a face to face meeting) or involve 'knowing the behaviours of a group of customers with certain attributes shared with the applicant'. The technique may also often involve simply looking at the customer's performance on a previous loan with the same lender

So once again, this reality raises questions of 'better regulation'. The upshot of what we have said is that the CP33 'knowing the customer' process may, in fact, have little to do with the way the lender (in a modern credit market) efficiently assesses the likelihood of repayment. In other words, the 'knowing the customer' process may (ironically) interfere with the customer getting the best, most predictive, credit decision.

CONCEPT CRITIQUE - 'SUITABILITY'

This issues raised by this concept are very similar to those raised by 'knowing your customer'.

Modern credit markets work on the basis that consumers apply for loans. Lenders grant those loans if they believe there is a reasonable chance they will be repaid. This is a simple and straightforward proposition and is one reason why modern credit markets are so efficient[42].

'Suitability' routines are likely to seriously erode those market efficiencies. Once again, the 'better regulation' principles are engaged.

If policymakers wish markets to be efficient and as accessible as possible, that needs to be weighed in the balance against the inefficiencies (and reduced access) that 'suitability' routines would introduce together with any 'benefits' (probably quite limited) that such routines might offer.

In addition, any such 'better regulation' analysis should, we argue, take account of the reality that most debt problems are in fact caused by unexpected life events, such as job loss or divorce. Commenting on this, the MABS website notes that:

> *'…the most common reasons* [for money difficulties] *in our experience are changes in life's circumstance, illness, unemployment, relationship breakdown, a drop in income, increased expenditure* [and] *just not enough to go around'.*

Because no 'suitability' routine can predict an unexpected life event, such routines are unlikely in practice to make much difference to the incidence of debt problems. This therefore calls into question the value that would derive from such routines.

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[42] The 2004 White Paper suggests that *'…it is important to assess carefully whether or not the existing situation can be resolved through market mechanisms'.* We think that in the case of unsecured consumer credit, there is a very obvious market mechanism: if a lender makes a bad loan, he loses money. Unsecured lenders have every interest in making the best lending decisions that they can.

CONCEPT CRITIQUE - ‘UNSOLICITED CONTACT’

Again, this is a concept that may make total sense for investment or insurance products. It is, however, worth stressing that these products are not capable of being supplied on an illegal basis.

By contrast, this is the central problem in the context of credit. **Banning (or seriously inhibiting) legal suppliers’ ability to ‘cold call’ simply opens up a market opportunity for illegal traders**. It also inhibits competitive forces.

As we have explained, home credit traders see the ability to cold call to sell **non-cash** credit as an important (and responsible) way to win new business and so to ensure competitive markets.

In ‘better regulation’ terms, we do not see that the case for the current proposal has been made out. For example, we are not aware of customer complaints concerning the selling of non-cash credit.

We believe that the already-existing right of withdrawal enshrined in the 1995 Act is instead a more appropriate way to approach this issue.

CONCEPT CRITIQUE - ‘COMPLAINTS’

In our response to CP10, we discussed at length our concerns about the definition of ‘complaint’.

Again, from a ‘better regulation’ perspective we believe that the onerous complaint handling processes in CP33 should only apply to what might be termed a complaint ‘of some substance’. Substance would be assumed if the complaint was received in writing, if it was self-evidently of a serious nature or if it was escalated in some way.

Again, as before, we believe that this must be looked at in ‘better regulation’ terms.

A 'LEVEL PLAYING FIELD'?

We can see the superficial appeal of 'level playing field' arguments in support of CP33. However, there are a series of key counter arguments:

- **most important are the potential adverse effects for current home credit users**. A significant proportion of this group will suffer consumer detriment if CP33 is applied in its current form. These adverse outcomes include financial exclusion and increased exposure to illegal lending markets.
- at the technical level, many of the **CP33 concepts are wholly disproportionate when set against the very small size of home credit loans**. A typical home credit loan would be in the range of €200 to €700. Even for credit unions, the average loan size is €8,150.
- the **disproportionality problems are made worse** by the sheer **frequency of the contacts** with the customers (which the customers appreciate and value) and the **frequency** with which customers take out **new contracts**.
- the Consumer Credit Act 1995 ('the Act') contains a set of special rules for moneylenders. **So the Act has, in effect, already tipped the 'playing field' against home credit traders**. There is no immediate prospect of change here.

In fact, the home credit sector has long supported the concept of a 'level playing field', **provided that the rules are set at a workable level for all players**. However, CP33 (which, in effect, extends CPC to moneylending) is not currently workable for home credit.

In fact, we argue that there is a powerful case for revisiting CPC in its entirety and across all sectors it covers.

Such a review would explore whether the compulsory duties 'to advise', 'to know the customer', 'to ensure suitability' and 'to maintain records' are, in fact, adding value in other market sectors, or whether in truth they are creating inefficiencies (that outweigh potential benefits) within those markets.

A review of this type would be fully in line with 'better regulation' principles.

CONCLUSION AND RECOMMENDATIONS

We believe that in its current form, CP33 runs counter to 'better regulation' principles. And even though it is a well-intentioned proposal, it will end up harming consumers.

The policy considerations for home credit differ from those that apply to the 'mainstream' sector. A key reason is that a significant proportion of home credit users have only limited credit options. CP33 will create financial exclusion within this group. Indeed, some in the group are likely, as a result, to move into the illegal market for credit.

In our 2005 CP10 submission we argued that there were compelling reasons for treating the home credit sector differently from other sectors.

We still hold that view and we would wish to engage further with the Financial Regulator with a view to seeing whether it is possible to rework those parts of CP33 that are likely to create the adverse unintended outcomes we describe.

We also believe that if CPC as a whole is to be reviewed in early 2009 (as stated in the FR's Strategic Plan), the CP33 process must be postponed. To proceed would place an unacceptable administrative burden on the sector.