No case for a cap?: Why the DTI has got it wrong

DEBT ON OUR DOORSTEP
A NETWORK FOR FAIR FINANCE

Background

In December 2003, the Department of Trade and Industry (DTI) published its long awaited White Paper on Consumer Credit. The proposals from the DTI followed considerable consultation on many aspects of the Consumer Credit Act 1974, including the effectiveness of the provisions within that Act to deal with extortionate lending.

Since its inception, Debt on our Doorstep has maintained that the current law seeking to prevent extortionate credit has been failing consumers, and low income consumers in particular. Profits of home credit lenders, such as Provident Financial have continued to boom, whilst borrowers face APR charges of in excess of 150%.

It was welcome, therefore, that the DTI recognised the failure of the current law in its White Paper. However, the DTI has consistently set itself against the use of any form of statutory interest rate cap as a means of tackling extortionate credit.

At the time of publishing the White Paper, the DTI stated that it was 'not persuaded' of the case for an interest rate ceiling, but that it would commission research into the ways in which caps operate in other European countries to test what it perceived as three failings of statutory rate controls. The DTI suggested that these were:

(i) The tendency for the level of the cap to become the 'going rate' charged by lenders – effectively raising the price of credit;
(ii) The risk that introducing a cap would cause lenders to move out of the market, making it harder for people to obtain credit; and
(iii) The increased risk that people unable to obtain credit from legitimate lenders would turn to illegal lenders in their place.

The DTI commissioned the research group Policis to undertake the research into interest rate caps on their behalf and Debt on our Doorstep understands that this is due to be published within the month. We have seen a copy of the draft report from Policis and have raised a number of significant concerns about the quality of the report, and the inaccurate conclusions that it draws.

In many other European countries including France, Germany, Holland, Italy and Switzerland, and in over half of the states in the USA, there are controls on the amount of interest that can be charged for consumer credit agreements. The level of the caps vary, and the effectiveness of different types of rate cap vary also. An analysis of the effectiveness of different mechanisms for controlling was therefore much needed.

What conclusions does the research make?

The report does rule out the first concern of the DTI, that interest rate caps become a ‘going rate’ for credit. No evidence whatsoever was found to support that assertion – made on numerous occasions by lenders in this country as grounds for opposing a cap.

However, the report also goes on to construct an argument that the second and third concerns of the DTI are supported by evidence on the contrary. The way in which this argument is made and the failure to take into account evidence that contradicts this suggests to Debt on our Doorstep that the exercise has been less than objective.

What are the concerns about the Policis Research?

The concerns are many and varied, ranging from a lack of transaprency about the information on which Policis draw their conclusions, through to a lack of academic rigour in analysing statistical information. Here are a few of the points we have raised with the DTI:

- Policis did not contact any consumer representatives in the countries that they researched. There has been a substantial amount of work done by consumer groups in the USA and in Europe that supports the case for interest rate caps – none of which is reflected in the Policis report.

Debt on our Doorstep believes that there is evidence that caps can cause lenders to restrict lending to riskier customers, but that this only occurs where the level of the cap is set at too low a rate. None of the countries researched by Policis had rate caps of more than 36%, so it is unsurprising that the report finds evidence that commercial lenders have restricted lending in some ways.

Debt on our Doorstep has referred the DTI to academic research concerning the Italian system (which was not researched by Policis) which comes to the opposite conclusion that Policis reach when commenting on France and Germany.

- The report failed to assess whether or not the degree to which lenders restricted the availability of credit was linked to the level of the cap – which would have shed some light on this issue. In fact, the DTI later confirmed that:

> *“The research does not set out to estimate the degree of credit exclusion for different levels of cap.”*[1]

The report is therefore almost entirely useless in informing a decision about whether caps work in general terms. At best, we are still only able to conclude that caps show some of the features of which the DTI was concerned where the rate of the cap is 36% or below.

- Policis have taken at face value comments made to them by leading sub-prime lenders. For example, Debt on our Doorstep referred Policis to the results of a recent survey of home credit borrowers in Leicester. This found that borrowers were having to take out larger and larger loans as time went on. But the Policis report uses an average loan amount that has been provided to them by the industry when comparing the costs of borrowing from this market with other products in Europe and the U.S.

- The researchers also reveal that they have accepted evidence from industry as valid, without making the reasons for this transparent. For example, the DTI comment:

- “Policis’ understanding is.. that intervals between home credit loans are getting longer and that the better off home credit borrowers in work, historically most likely to take on the largest home credit loans, are increasingly turning to credit cards and cheaper, higher value remote loans.”

The report does not, however, present evidence for this understanding, or source the information on which it is based.

- There is also a complete failure of the report to consider the scale of alternative lending sources available to low income borrowers on the continent. For example, Germany has a system of publicly owned banks (the Sparkassen). This is a multi-billion euro operation, serving many thousands of low income customers. Yet Policis report that this is somehow failing those customers. This is based on their own consumer survey which found that only 9% of the people they surveyed who had borrowed from the Sparkassen in the past 12 months, were on the lowest incomes. The report, however, fails to set out the methodology of the consumer survey or to present statistical information which could have been obtained from the Sparkassen itself.

- The report provides an analysis from consumer surveys in France and Germany concerning the degree of illegal lending in those countries. This purports to show that the extent of this is higher than in the UK.

> *“Our inference is simply that… credit impaired consumers in France and Germany appear more likely to use illegal lenders than those in the UK where there are legal, albeit high cost, credit options for such borrowers.”*

However, no assessment is made of the nature of illegal lending in France and Germany, and the effects of this for consumers. Is illegal lending in Europe associated with the same problems of loan sharking in the UK, or are we talking here of unlicensed, informal lending amongst communities. The report has no answer:

“The research did not set out to consider the nature or cost of illegal lending…evidence of this issue is necessarily anecdotal.”

What now?

Debt on our Doorstep believes that the DTI should not accept the findings of the Policis report as they stand. The research appears to us to be deeply flawed. We have asked that the DTI consult with consumer groups and academics in Europe regarding the report’s findings. To date the DTI have not indicated a willingness to do this.

But even if the report’s conclusions could be accepted, they only show that it is the level of the cap that is the critical issue. A cap that is set at too low a rate will inevitably cause lenders to restrict access to credit. For these reasons the DTI should look at how a cap could be introduced at a level that was sensitive to the needs of lenders to make a profit, but also provided real protection to poorer borrowers.

1 All quotes, letter from DTI to Damon Gibbons, 19th May 2004

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