



## Reforming Financial Markets

Debt on our Doorstep is pleased to respond to the Treasury's consultation on the measures now needed to reform financial markets so that they better serve the needs of UK households and businesses in the future. We have four main concerns with the analysis provided in the White Paper. These are:

- There is an inadequate emphasis on the need for better consumer protection to prevent another crisis from re-occurring. In particular, there is still a tension between the remit of the Financial Services Authority to protect consumers and its wider objective to ensure that the U.K's regulatory framework maintains the competitiveness of the financial sector. One of the main lessons of the crisis is that regulatory competition has resulted in a 'race to the bottom' which has allowed excessive risk taking to occur. This needs to be rectified.
- There is insufficient analysis of the UK's sub-prime credit markets, how these were created, and how the current crisis is now leading them to grow significantly. The dynamic of recession, 'flight to quality', and targeting of sub-prime markets which started in the late 1980's is now in danger of being replicated on a larger scale. Failure of competition in the sub-prime markets, predatory lending practices, and excessive pricing are not addressed by the Treasury's current proposals. This is despite the fact that the growth of these sub-prime markets throughout the world but particularly in the U.S and U.K was a direct cause of the current crisis. It is not adequate to lay all of the blame for this crisis on problems being imported to the U.K as a result of failures within the U.S sub-prime market when the U.K was following precisely the same route. Mechanisms must be found to limit risk taking in terms of the leverage of low income households and the prices/ risks that they are taking. We are unconvinced that capital adequacy requirements and international accounting standards being pursued by the Financial Stability Board will achieve this – in fact

there are plenty of reasons to consider that they drive forwards greater risk taking not less<sup>1</sup>.

- There is no appreciation of the need to rehabilitate those people currently being pushed into default on their credit agreements (through loss of jobs or simply because they can no longer access credit to reschedule their commitments) back into the financial mainstream. People are now defaulting because of the greed and irresponsibility of bankers. Many people may not have themselves become too highly leveraged but may nevertheless find themselves out of a job and facing insolvency. Maintaining homes and helping them get debt advice is not an adequate response. They should also be rehabilitated to the financial mainstream, which will require the swift restoration of credit scores.
- There is no direct mention of the trade-off that must now take place between economic growth and financial stability. The Treasury needs to ensure that sustainable growth targets for the U.K also set out the expected level of household and business debt leverage that will be required to meet these.

We find the absence of sufficient rigorous assessment of these issues extremely disappointing and note that many of the preferred measures outlined in the report will not therefore help low to middle income consumers deal with the problems posed by the crisis or ensure that sub-prime lending markets do not continue to expand in the future.

As an immediate programme of reform we therefore call for:

- The FSA's governing principles to be reviewed and for the protection of consumers to be given primacy over the need to maintain a competitive financial sector.

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<sup>1</sup> See for example, French, S., & Leyshon, A. (2004). The new, new financial system? Towards a conceptualization of financial reintermediation. *Review of International Political Economy*, 11 (2), pp. 263 – 288; Hammond, T. H., & Knott, J. H. (1988). The Deregulatory Snowball: Explaining Deregulation in the Financial Industry. *The Journal of Politics*, 50 (1), pp. 3-30; Mayer, C. (2001). Regulatory Principles and the Financial Services and Markets Act 2000. In E. Ferran, & C. A. Goodhart (Eds.), *Regulating Financial Services and Markets in the Twenty First Century*.

- Primary legislation being taken forwards in the forthcoming Queen's Speech to include granting a power to the OFT and FSA (or any subsequent body) to impose price ceilings in credit markets which they determine are failing to deliver effective price competition, or where the risks being taken by lenders (as reflected by the prices being charged) are clearly excessive. Limiting prices is the simplest and most effective means of limiting risk
- Limits to be placed on the amount of household debt leverage that is allowed to occur. Establishing norms of responsible loan to income ratios would be helpful in both the mortgage and consumer credit markets. These norms should be taken into account in Treasury economic models and published as part of the Budget.
- An immediate review of insolvency legislation and credit scoring mechanisms to ensure that those households which default on their existing credit agreements as a result of unemployment or because they have been refused an opportunity to reschedule their debts are treated fairly and rehabilitated as soon as possible back to the financial mainstream
- Government to insist that lenders that have received Government or Central Bank assistance now use this to help those that are in most need. This means forcing lenders to pass on base rate cuts to households that have little or no equity in their homes, rather than reserving the best rates for the wealthiest households. The present position will cause a dramatic increase in inequality. Government should require financial institutions to offer opportunities for people in debt to reschedule their commitments at today's lower costs of borrowing rather than being forced into default
- Acting to ensure that lenders disclose how they have spent Government funds provided through agreements with the Treasury and subject to Lending Panel scrutiny, including setting out in their annual reports how their mortgage and consumer credit lending is allocated by income group.

- Establish an independent Commission to examine the case for Community Reinvestment Act type legislation in the U.K in order to boost levels of affordable credit to low income groups