



**Responsible Credit:
Proposals for Action
October 2007**



Contents

Our Proposals for Action	3
1. Mainstream financial services must re-engage with low income households:.....	3
2. Irresponsible lending must be prevented:.....	3
3. Default charges must be fair and transparent	4
4. Greater efforts must be made to stop illegal lending:	5
5. The cost of credit must be transparent and fair, and harmful lending stopped: ...	5
6. A comprehensive national debt advice service is required.	6
7. Regulation must be improved and enforcement strengthened.	6
8. Government needs to join up its response	7
Background to the Proposals:	8
Why We Need Responsible Credit.....	8
Appendix 1: Joint Dood & ECRC statement on the sub-prime crisis (18/09/2007).....	14
The cause of the current crisis – US lender irresponsibility and greed.....	14
Global financial services transmit risks from the US to Europe	14
The Credit Crunch	15
What Next in the UK?	15
Why we need banking for the people	16

Our Proposals for Action

1. *Mainstream financial services must re-engage with low income households:*

- (a) Banks and mainstream lenders should be required to disclose, in a standard format, details of their service provision to low income communities¹. The Government should set targets for the financial services industry to ensure that all low income households have access to banking facilities and to suitable credit products including small sum overdraft facilities². Legislation should be considered to bring about community re-engagement from banks if this fails to significantly improve the level of services within a two year time-frame.
- (b) Resources should be directed to those areas where banks are not currently providing services to low income groups. Banks and the wider financial services industry should play an increased role in supporting Credit Union and CDFI development, and targets should be set for the industry to increase its donations to this sector. The Government should make clear its ambition to bring affordable credit to low income households by defining what it means by the term 'affordable' and conducting research to establish targets for this work. Social Fund provision should be reviewed to ensure leverage from the private sector to support this work.
- (c) Financial inclusion objectives should be incorporated into the Local Area Agreement process with clear milestones for delivery laid out and monitored by the regional Government Offices. Local strategic partnerships should be given resources to develop appropriate responses for their areas.

2. *Irresponsible lending must be prevented:*

- (a) The 'irresponsible lending' provisions in the consumer credit licensing regime that are due to be brought into effect by the Consumer Credit Act 2006 should include a requirement that all lenders take proper account of a borrowers' ability to repay. The term 'ability to repay' must itself be defined and guidance given that will prevent low income households from falling into credit dependency³. In particular, ability to repay should not be taken to mean ability to make only the minimum repayments on credit cards.

¹ Following the recommendations of the New Economics Foundation and Woodstock Institute Research, December 2006, and the Social Investment Taskforce, 2000.

² At the moment, the only targets given are in relation to the opening of basic bank accounts.

³ We use the term 'credit dependency' to refer to low income households becoming trapped in a constant spiral of debt consolidation and refinancing. Lending at high cost to people on low incomes reduces their disposable income to the extent that they have a virtually permanent demand for more borrowing.

- (b) The OFT should work with consumer agencies and the financial services industry to design standard approaches to determining a consumer's ability to repay. The British Bankers Association and Money Advice Trust have developed a common financial statement used when dealing with debt that could be adapted for this purpose.
- (c) Credit card lenders should be prevented from making unsolicited increases in credit limits⁴, and minimum repayment levels on credit cards must be set at a rate that will clear the principal and interest within a reasonable period of time⁵. Credit card statements should state clearly how long it will take the borrower to clear their debts at the current level of repayment. The Government should introduce its promised secondary legislation to ban the unsolicited issuing of credit card cheques⁶.
- (d) Action needs to be taken to prevent problems of credit dependency and inappropriate debt consolidation. In particular, the OFT and FSA should lead an industry wide initiative to develop standards to ensure that borrowers in financial difficulties do not become increasingly indebted by the constant rolling over of credit agreements.
- (e) Whilst increased use of data sharing is welcome, this must be put to appropriate use by the industry and a requirement that they take account of total indebtedness at the time of making a loan should be included in the responsible lending guidance. Increasing the level of information available to lenders should not be used as a tool to increase 'risk based pricing' and to remove remaining cross subsidies from poorer borrowers⁷.

3. *Default charges must be fair and transparent and consumers provided with redress for previous excess charges:*

- (f) Government should take action to force lenders to repay excess credit card default charges – estimated to be worth £1.8 billion – to borrowers within the next six months. The OFT should act against the practice of levying multiple fees for a single default⁸.

⁴ This was identified as an irresponsible practice in the Government White Paper ('Fair, Clear, & Competitive', DTI) in 2003 yet has still not been addressed.

⁵ This was identified as a problem by the Treasury Select Committee in 2003 but in fact minimum repayments required by credit card companies have fallen since that date to 2.5%, which barely covers the interest. As interest rates rise the value of the minimum payment is also eroded.

⁶ The Government made a promise to introduce secondary legislation to prevent unsolicited credit card cheques from being issued during the passage of the Consumer Credit Act 2006.

⁷ Lenders have shared 'positive' data in the UK since 2005 and this was applauded as a measure to prevent over-indebtedness. However, in the US lenders have shared data in this way since the 1970's. They have instead used the information to target credit on low income groups and remove cross subsidies for poor borrowers, increasing the cost of credit for the poorest and reducing it further for the wealthiest.

⁸ Although the OFT action on credit card default fees established an industry standard of £12, lenders circumvent this by charging a series of £12 fees for a single default (for example an 'over-limit fee' and a 'deferred cheque' fee) whilst also increasing the interest on the agreement as a penalty.

- (g) The Banking Code should be revised to include a clear requirement that banks recover only the true costs of default on current accounts and loans⁹.
- (h) Government should ensure that banks reimburse consumers for any unlawful charges following the test case without requiring individual consumers to take out their own legal action.

4. Greater efforts must be made to stop illegal lending:

- (a) We welcome the fact that the DTI's successful illegal lending pilots are being rolled out nationally, and support the greater level of resources that are being devoted to the existing services in Birmingham and Glasgow. However, a commitment must be made to provide funding for these schemes on a long term basis.
- (b) We also call upon the Government to ensure that any recovered proceeds of illegal lending are ring-fenced and used to support affordable credit provision in those areas with the greatest illegal lending problems.
- (c) Further to this, the Government should consider introducing a specific criminal offence of usury to make prosecution of illegal lenders easier and to provide a deterrent to illegal lending by providing for harsher sentencing for usurious lenders.

5. The cost of credit must be transparent and fair, and socially harmful lending stopped:

- (a) Credit pricing must be made more transparent. In particular, the industry should publish details of the factors taken into account when determining the interest rate offered to borrowers following a loan application, and the relative weighting that they have applied to these. Where the rate offered to a borrower is higher than the advertised rate, lenders should be under an obligation to state clearly why the applicant's credit score was not adequate to support the offer of the lower rate.
- (b) Where Payment Protection Insurance (PPI) is offered with the loan, whether optional or not, then lenders should advertise the APR for both the loan on its own and also for the loan with PPI included¹⁰. 'Typical APR's' should include the costs of PPI where more than one third of customers are expected to take out insurance with the loan.
- (c) The Government should set out a timetable for its promised review of its decision not to implement interest rate caps¹¹. This should take place within the

⁹ This proposal simply asks for lenders to acknowledge the legal position and incorporate it into the Code.

¹⁰ We believe that this was the intention of the Consumer Credit (Agreements) Regulations but due to lack of clarity in their drafting this has been frustrated.

¹¹ A review was promised during the passage of the Consumer Credit Act 2006

next two years and incorporate an independent evaluation of the impact of the Competition Commission remedies on prices in the Home Credit industry. The review should be informed by research into the problems caused by Pay Day lending, Rent to Own stores (e.g. BrightHouse), and Auto Title Lending, and into the effectiveness of the Unfair Credit Relationship provisions of the Consumer Credit Act 2006.

6. *A comprehensive national debt advice service is required*¹².

The Government should set out its plans for the development of a comprehensive national network of not for profit debt advice services, operating to a single set of quality standards and independent from the financial services industry. Provision must be expanded so that this reflects need. Funding should be sustainable and long term with increased contributions secured from the financial services sector for this purpose. Short term initiatives, such as the Financial Inclusion Fund, must be developed into longer term strategies and properly resourced.

7. *Regulation must be improved and enforcement strengthened.*

- (a) The regulators should conduct regular programmes of mystery shopping to check compliance with legislation and guidance. At the moment the process is over-reliant on consumer complaints. The mystery shopping work that has been conducted by the FSA in relation to Payment Protection Insurance and Sub-Prime Mortgage issues is an example of good practice, but greater resources should be made available to regulators to extend this approach into other areas.
- (b) Membership of the Banking Code Standards Advisory Board should be immediately reviewed to include consumer representatives. The Banking Code Standards Board should publish details of its activities and make public the outcome of its actions, naming the banks which have been subject to investigation.
- (c) Enforcement action taken by regulators should be directed at providing redress for consumers – fining the industry, although appropriate in some circumstances, is no substitute for ensuring that amounts excessively or inappropriately charged are returned to consumers themselves. Where action is taken under voluntary codes of practice then the details of these should be made publicly available. The outcomes of action – in terms of amounts recovered for consumers – should be a key performance indicator on which the FSA and OFT report publicly.

¹² Recent research into the impact of debt advice services has been published by the Ministry of Justice and confirms that advice can significantly reduce the amounts of debt outstanding.

8. *Government needs to join up its response*

- (a) The Government needs to revitalise the way in which it engages with the debt advice, credit union, and community sector. The current over-indebtedness advisory group and Financial Inclusion Task Force should be merged so that issues of responsibility and access are discussed together. The resulting group should be chaired by a Minister with representation from the industry, debt advice sector, and consumer and community sectors. The selection of representatives should be more transparent and should not include predatory lenders or their associations.
- (b) Research into the impact of indebtedness on the Government's targets to eradicate child poverty should be commissioned immediately. The Treasury should take the lead role on developing future Over-indebtedness Action Plans and these should reflect the structure of the recent Council of Europe recommendation. The Government should commission an independent audit of progress each year in order to inform future planning.

Background to the Proposals:

Why We Need Responsible Credit

As at the time of writing, British personal debt exceeds £1.3 trillion¹³ - an average of £8,856 per household (excluding mortgages) and £26,971 per adult (including mortgages). 8.2m British adults are in serious debt¹⁴ and 2.1m are struggling with repayments - a rise of 30% on last year¹⁵.

Britons now account for one third of all debt in Western Europe. Although the majority of our debt is secured on property (£1.05 trillion), net secured lending has out-stripped the growth in house prices over the past 12 months (11%¹⁶ compared to 9.6%¹⁷) and the increase in the overall level of indebtedness means that households are increasingly sensitive to interest rate rises¹⁸.

Prior to January's increase in interest rates to 5.25%, Deloitte warned:

*"Households are... set to be devoting more of their money to servicing their debt... a further rise in interest rates to 5% could take interest payments as a share of income to their highest level since 1992"*¹⁹

With the base rate now standing at 5.75%, and with the recent credit crunch creating further upward pressure on mortgage rates, this position is set to worsen further.

Already, there is evidence that consumers are starting to struggle. The number of county court judgments (CCJs) has risen to a near 10-year high. A total of 247,187 consumer debt related CCJs were issued in the first three months of the year - the highest quarterly total since the summer of 1997²⁰.

Over 30,000 mortgage repossession actions have been started in each quarter since the end of 2005 – a total of 229,821 households in less than two years²¹. Approximately 25,000 people are now entering insolvency in each quarter with the total number of insolvencies for the year forecast to equate to the entire population of Exeter.²²

¹³ Bank of England, July 2007

¹⁴ Owing more than 10K and paying out an average of 7% of net incomes on debt repayments. The position is worse for low income households which spend an average of 11% of their income on repayments – see 'Taxing Times for the Poor', Debt on our Doorstep, May 2007

¹⁵ Research commissioned by Thomas Charles and conducted by YouGov

¹⁶ Bank of England, July 2007

¹⁷ Nationwide Building Society House Price Index, August 2007

¹⁸ This is particularly true of those households that cannot afford the fees to move their mortgage onto discounted or fixed rates.

¹⁹ Economic Review – The Financial Services Sector, Fourth Quarter 2006, Deloitte

²⁰ Taken from Credit Action website, 1st September 2007

²¹ Ministry of Justice, statistics on landlord and mortgage possession actions, August 2007

²² 100,000 – thanks to Credit Action for this comparator.

These indicators reveal a growth in financial problems at a time when general economic performance in respect of employment levels and average income growth remains relatively strong. We attribute this phenomenon to irresponsible lending.

According to uSwitch, almost eight out of ten loans are issued without checks being made to see if the borrower can afford to repay the debt, and almost 1.6 million loans have been approved without properly verifying people's incomes. 763,000 loans were issued last year for debt consolidation purposes and yet 91% of these borrowers were not asked to prove that other forms of credit had been closed with the proceeds of the consolidation loan.

In June 2007, 34% of all new mortgages were 'interest only' compared to just 12% in July 2003 and in 23% of cases there was no mechanism sold with the mortgage that would repay the capital at the end of the term²³.

The sub-prime mortgage market exhibits these problems in particular, with the FSA concluding its 2007 investigation into lender practices with the following:

"None of the lenders adequately covered all relevant responsible lending considerations in their policies. For example, some firms' lending policies contained unclear affordability or self-certification requirements.

In many cases, lenders did not apply their own policies in practice. For example, some firms failed to check the plausibility of information, as required by their own lending policy.

There were also failings by lenders to monitor the application of their policies, which resulted in the approval of potentially unaffordable mortgages. "

According to the Bank of England 29% of consumers with debt problems consider that this has been caused by over-spending. This nearly matches those reporting problems caused by unforeseen changes of circumstance traditionally seen as the precursors to debt (32%).²⁴

Over-commitment now poses a serious threat to British consumers, and an increase in unemployment, or interest rate increases of just a few percentage points could tip many more thousands of households into over-indebtedness.

Savings levels are inadequate to form a buffer in this scenario. Over one quarter of all households, and 44% of the poorest, have no savings at all, and a further 22% of households have savings of less than £1500²⁵.

Neither are payment protection insurance (PPI) schemes likely to rescue consumers, subject as they are to investigation by the Competition Commission, and under criticism for failure to pay out when consumers need them most.

²³ Credit Action website, 28th December 2006

²⁴ Changes of circumstances causing debt are redundancy, unemployment, illness, loss of overtime, divorce/ relationship breakdown.

²⁵ Family Resources survey 2004/05, Department of Work and Pensions.

The consequences of the last recession are still being felt. People defaulting on loan repayments and mortgages in the early 1990's, together with those groups of people with greater reliance upon benefit incomes²⁶, have effectively been cast out of the mainstream credit market and forced to turn to sub-prime and alternative credit providers.

These markets have been inadequately regulated and this will impact on the overall economic position in the UK. We are currently witnessing the effect of the US sub-prime market meltdown on UK mortgage rates, as liquidity in the capital markets becomes restricted. These factors will be intensified in the UK when its own sub-prime market starts to stall²⁷.

Whilst the mainstream market shrinks with every missed repayment, county court judgment, mortgage repossession and insolvency; the sub-prime market grows ever bigger, and more and more people see the cost of their credit rise – reducing the level of disposable income available to meet essential needs in the present. The result is to deepen the level of hardship and poverty amongst the poorest and to create a group of people who must continue to take credit at high prices in order to meet their need for current consumption. This is credit being used at its most unproductive and destructive.

Neither is the price paid in the sub-prime and non standard lending markets a fair one. Instead, we witness a lack of price competition combined with unfair and predatory lending practices. They also promote a cultural acceptance that the poor should pay more for services despite considerable evidence that they are not inherently less credit-worthy than those on higher incomes²⁸.

In our view it is often the cost of the credit itself that causes those on lower incomes to become trapped in a cycle of refinancing, indebtedness, and credit dependency.

It is therefore unsurprising that levels of debt are relatively higher amongst those on the lowest incomes. Those who are over-represented on the over-indebtedness indicators are typically those who earn less than £9,500 a year; are in their 20's or 30's; have children; and/or are renting accommodation²⁹.

The consequences can be severe and the indicators of the problem are not limited to credit or mortgage arrears. Ofgem estimate that there are 4 million households experiencing fuel poverty in the UK³⁰. 2006 saw 8.3 million letters sent out by water suppliers threatening people with legal action for non payment – an increase of 43% on the previous year. An estimated 2 million people are struggling with Council Tax payments and face sanctions including bailiff action and possible imprisonment. Debt has been identified as a cause of relationship breakdown, employment difficulty, mental health problems, and homelessness.

²⁶ Pensioners, lone parents, unemployed, and people with life-limiting illness or disability.

²⁷ For an analysis of the impact of the US sub-prime market on the UK see appendix 1

²⁸ For example, witness the repayment levels of micro-credit advanced in this country by Fair Finance, which reports bad debt levels of only 1.2% on loans provided to low income borrowers in Tower Hamlets.

²⁹ Over-indebtedness in Britain, A DTI Report on the MORI Financial Services Survey, 2004

³⁰ Defined as households that spend more than 10% of their income on heating their home.

The financial services industry has not shown any long term interest in preventing these problems. Many mainstream financial services providers have embraced the sub-prime and alternative credit markets as areas where greater profits can be made and have either invested as shareholders in alternative credit companies or established subsidiaries to take direct advantage of the growth in sub-prime demand.

In fact, many of the practices of the mainstream seem designed to accelerate the process of over-indebtedness and fuel the growth of the sub-prime market. These include the levying of punitive default charges, the cross-selling of useless, and high cost, 'insurance' products, the failure to adequately contribute to the funding of independent debt advice services, the use of individualised 'risk pricing' without transparency, and the lack of rehabilitation of debtors to mainstream status through the credit referencing system.

Our regulation of the industry is also failing consumers. The Department of Trade & Industry and the two main regulatory bodies (the Office of Fair Trading and the Financial Services Authority) have, in the main, accepted the industry arguments for 'self-regulation' (for example through the Banking Code), or promoted the use of ill-defined principles (for example, the Unfair Relationship test contained within the Consumer Credit Act 2006 and the FSA's 'Treating Customers Fairly' initiative). There is no transparency for consumers in this type of approach, and no real means of redress for groups of consumers that have been ripped off.³¹

In October 2006, the FSA fined Loans.co.uk, £455,000 for its failure to have adequate systems in place to ensure that its payment protection insurance was being sold appropriately. According to the FSA, over 14,000 customers were exposed and could have been mis-sold insurance policies as a result. Whilst Loans.co.uk are required to implement a remedial plan "which involves a customer contact exercise and redress where appropriate", the FSA confirmed to Debt on our Doorstep that they had no plans to monitor how many customers were actually reimbursed as a result.

In April 2006, the OFT announced its findings that default charges on credit card transactions amounting to over £12 were probably illegal. However, it has done nothing to ensure that lenders refunded their charges above that level – with the result that nearly 6 million borrowers are currently owed a total of £1.8 billion by their credit card lenders but will have to take individual action through the courts to recover this. The OFT position in relation to other default charges (for example in relation to current account charges) has been even more deplorable.³²

Neither is action taken under the Banking Code transparent or effective for consumers. The Code is always in the position of playing catch up with the industry. If action is taken following complaints to the code, then consumers are the last to find out what these have been. In December 2004, the BBC's Real Story programme reported on the irresponsible lending practices of Lloyds TSB. The programme, which highlighted the case of a couple reliant upon disability benefits being loaned over £20,000, passed

³¹ For example, Yes Car Credit customers have received no help from the regulators despite considerable evidence that they were systematically mis-sold insurance policies – see www.saynotoyes.co.uk for more details.

³² For full details of the campaign to recover illegal bank charges see the Consumer Action Group website – www.consumeractiongroup.co.uk and the BBC report – Bank Robbery, at <http://news.bbc.co.uk/1/hi/business/6169539.stm>

on their files to the Banking Code Standards Board. The Board, however, cannot publish details of any consequent action that will be taken as a result of its confidentiality agreement with the industry³³.

Consumers themselves are not able to test out the claims of the financial services industry prior to signing agreements. Mystery shopping lenders is impossible as prices are only revealed following actual applications (rates are advertised as 'typical' and exclude PPI), and pretending to be someone else is of course fraud in relation to a credit application. So it remains impossible for independent consumer advocates to go through a complete application for credit as a mystery shopping exercise to test the procedures that lenders have in place. In almost every other sphere of activity this is possible but not in relation to financial services.

And so we find that the mainstream credit market continues to shrink, bad debts rise, lenders tighten their criteria (now transforming themselves into 'responsible lenders' because of the credit crunch), and more people are forced out into the arms of extortionate and predatory lenders.

Government and the regulators are failing to act decisively to prevent the mechanisms by which irresponsible lending becomes accelerated into over-indebtedness and which fuels the growth of the sub-prime market.

Those reliant upon the sub-prime markets pay the highest prices for their credit, and are least able to do so. This is not simply a reflection of greater levels of credit risk being reflected in higher prices. Nor is it a reflection that people reliant upon the market require greater levels of service than those in the mainstream (where costs have been significantly reduced by the closure of local branches and the move towards internet banking and automated processes). Following an 18 month long inquiry into the Home Credit industry, the Competition Commission found that:

*"...over the last five years home credit providers have been making profits of over £75 million a year in excess of that which could be expected in a more competitive market."*³⁴

The Commission introduced a package of reforms for the industry focused on ensuring greater data sharing, price transparency, and fairer rebates for borrowers when loans are refinanced.

But the need for reform is not limited to the Home Credit industry. The growth of payday lending in the UK reflects that the main selling point of credit amongst the poor is the provision of fast and easy access to cash with the minimum of questions. To prevent competition, lenders then look to trap borrowers in a cycle of refinancing with them. This is common throughout all the sub-prime vehicles for lending.

Whilst the US Defense Department has successfully obtained a 36% interest rate cap on payday loans³⁵, the UK appears to have turned its back to the problems of

³³ It is also worth noting that not a single consumer body is represented on the Banking Code Standards Board's User Group

³⁴ Competition Commission Press Release, 30th November 2006

³⁵ The cap is due to be implemented from October 2007

extortionate lending. At a meeting called by the Social Market Foundation on the issue of responsible lending in December 2006, the DTI's Director of Cross Market Interventions confirmed that it was unlikely that the new unfair credit relationships test contained within the Consumer Credit Act 2006 would allow borrowers to challenge agreements if the only issue was that of extortionately high interest rates. Instead the Government believes that if borrowers have freely entered into an agreement knowing the level of the interest and other aspects of the loan, then such an agreement will not be unfair.

Such a position requires both lenders and borrowers to be equal in bargaining power. In reality this is not the case.

Efforts to secure increased access to affordable credit in the UK have been limited by a failure to secure mainstream banking finance. In December 2006, a joint report by the New Economics Foundation and the U.S Woodstock Institute highlighted the lack of information available in the UK about bank lending and financial services to deprived communities when compared to the U.S. Calls for the banks to voluntarily disclose this information in the UK by the Social Investment Task Force from 2000 onwards have largely fallen on deaf ears. By contrast, the provisions of the US Community Reinvestment Act have secured trillions of dollars for use by affordable lending agencies in the states.

So in reflecting on the position of low income households in relation to the financial services industry in 2007, we have asked ourselves the question: What do we need to resolve to do to fundamentally change the position the better?

During the course of the year we have debated potential solutions with a wide range of stakeholders – most notably at our second UK Responsible Credit conference organised jointly with Citizens Advice Scotland in May, and with organisations from across Europe at the European Coalition for Responsible Credit (ECRC) conference held in Brussels in September. Indeed the development of these proposals draws heavily on the earlier work of the ECRC in developing the 'Principles of Responsible Credit' in 2005/06.

This work has now resulted in a set of practical proposals, which if adopted could make a positive difference to millions of credit consumers. We are now sending these proposals to every M.P and asking that they sign up to ensure fundamental change in the way financial services are provided in the UK.

If, reading this, you agree with our proposals then we also ask that you join us and write to your representative seeking their support and asking them what they will undertake to do to bring about the changes we are seeking. We believe that having access to credit can play an enormously positive and productive role in peoples' lives – but that to do so it must be **provided responsibly** and at an **affordable price**. We now ask our representatives to make those two goals a reality in the U.K.

Damon Gibbons, FRSA
Chair
Debt on our Doorstep

Appendix 1:

Joint Debt on our Doorstep and European Coalition for Responsible Credit statement on the sub-prime crisis (18/09/2007)

The cause of the current crisis – US lender irresponsibility and greed

“The causes of the credit crunch affecting Northern Rock clearly lie in the irresponsible lending practices of US sub-prime lenders. Mortgages have been provided to low income households in a variety of predatory and extortionate ways on the assumption that house price rises would protect the lender from the risks of default. However, not content with providing honest products that would enable poor people to access home ownership, the lenders constructed products that allowed them to be exploited (for example adjustable rate mortgages, and mis-sold ‘liar loans’ that did not require brokers to check applicants income details).

At the heart of the problem was a ‘get rich quick’ mentality of US sub-prime lenders and a lack of ethics or responsibility to the borrower in the long term.

With the downturn in the US economy these excessive risks have now come home to roost. Mortgage foreclosures in the US are at a record high, and the human cost is impacting at a political level with the US Government forced into intervening to protect genuine borrowers from bankruptcy.

Global financial services transmit risks from the US to Europe

The risks taken on by US sub-prime lenders have now been transmitted to mainstream credit markets in Europe through a variety of weird and wonderful methods of debt securitisation that were bought into by banks across the globe. In the same way that US sub-prime lenders did not care about the financial position of their applicants, the UK and European banks paid no attention to the true value of these financial instruments. As a result, no lender in the UK and Europe truly knows their own exposure³⁶.

Not knowing the level of exposure to these ‘junk bonds’ affects even those banks that have large levels of deposits. Even they are now unwilling to lend out cash without demanding a much higher price than previously - leading to rate rises that will ultimately cause problems for all households with mortgages or outstanding credit. The central banks have a choice of intervening with cash handouts for financial institutions that are worse hit – effectively subsidising the irresponsible with tax payer’s

³⁶ A fact reinforced by the September market summary from the Council of Mortgage Lenders (see their website).

money; or sitting back whilst more households struggle to cope with increased mortgage costs.

The Credit Crunch

Meanwhile the credit crunch affects more than those that are exposed to sub-prime risks. Northern Rock does not have much direct exposure. But, as a relatively small holder of deposits, its business model requires it to have access to large amounts of credit to fund further lending. In recent statements, Northern Rock states that they had recently scaled back their lending. That may be true in comparison to the past few years during which the company sought to grow at exponential levels.

But Northern Rock was also guilty of underestimating the likelihood of interest rate increases and had sold large numbers of mortgages on cheap fixed rate loans in order to attract a major market share. As a result, many of its borrowers are now paying back at lower rates than it must itself pay back its own creditors. To address this, Northern Rock had to raise finance to lend further. When it could not afford to obtain this at market rates it went to the central bank for help. For this reason, despite central bank assurances, the so-called naive and 'herd' behaviour of depositors seeking to take out their savings from Northern Rock is, in fact, rational behaviour. The company is not viable in today's changed market place – and that is reason enough for depositors (acting as small investors) to decide to switch their money elsewhere.

Those UK bankers that have been at the forefront of applauding the free movement of capital around the globe and have consistently advocated for the liberalisation of capital controls with little sympathy for the countries they deprive of investment, now find that they are victim to the same effects as their depositors remove their investments on en masse all over the country.

What Next in the UK?

The UK's own sub-prime housing market has been booming in recent years³⁷. As mainstream banks withdrew credit from low income households, and as house prices increased, the sub-prime lenders moved in. Regulation of this sector of the market has historically been weak. In 2005, the FSA warned that 60% of sub-prime mortgage loans were sold without proper knowledge of the applicants financial circumstances. In addition, they reported concerns about the suitability of sub-prime mortgages being sold as a means of debt consolidation:

"...in 80% of cases, there was lack of evidence to show how the recommended sub-prime product met the customer's needs and circumstances; and in 67% of those cases which involved debt consolidation, firms could not demonstrate that they had taken account of the additional requirements related to debt consolidation mortgages and thus it was unclear whether the recommendation was appropriate." (FSA press release, September 2005)

³⁷ Datamonitor report that the UK sub-prime market has been growing since 2004 and that gross lending increased by 28% in 2006 alone with exposed lenders including DB Mortgages (Deutsche Bank), Abbey, Alliance & Leicester.

Despite having issued good practice guidance to mortgage lenders and brokers, the FSA found on conclusion of a further investigation in July 2007 that:

“None of the lenders adequately covered all relevant responsible lending considerations in their policies. For example, some firms’ lending policies contained unclear affordability or self-certification requirements.

In many cases, lenders did not apply their own policies in practice. For example, some firms failed to check the plausibility of information, as required by their own lending policy.

There were also failings by lenders to monitor the application of their policies, which resulted in the approval of potentially unaffordable mortgages. “

These regulatory failings, coupled with rising mortgage rates and an increased overall debt burden amongst UK low income households is starting to lead to increased defaults and repossessions. Only last month, the Council of Mortgage Lenders in the UK revised their repossession figures to take account of the increased activity of sub-prime lenders in this respect.

The problems that we are witnessing in relation to the current US sub-prime market problems will be repeated in the UK, causing the credit crunch to become further entrenched.

The initial response of lenders will be for them to transform themselves into the advocates of responsible lending – repeating the so-called ‘flight to quality’ that caused the mainstream markets to desert low income communities in the late 1980’s and 1990’s, and which created the conditions for the rise of sub-prime lending. As the credit crunch will impact on both the housing and consumer credit markets, more and more people will become excluded from mainstream credit. Predatory Home Credit and Payday lenders must be rubbing their hands at such a prospect.

Why we need banking for the people

In the final analysis this process will result in a further entrenchment of the current segregated credit market – with larger numbers of people cast outside mainstream financial services being charged increased prices.

As genuine consumer advocates of access to responsible financial services, we urge the UK Government to think for the longer term and to introduce measures to expand credit through mainstream financial services to people on low incomes. We ask for them to end the current dual market for credit that has given rise to this current crisis – an injection of capital to financial institutions now must be coupled with requirements to meet the needs of the whole population for financial services at fair prices with strengthened regulation.

We call for financial services to meet their obligations – to provide both access to credit and to exercise ethics in the provision of that credit. Now, more than ever before, we need banking for the people.”

Join Debt on our Doorstep

Membership is open to :
 “Associations and organisations which are voluntary or non-profit distributing, and which wish to support or further the objects” of Debt on our Doorstep. Our constitution provides for organisational membership, with voting rights, and individual affiliation. The full constitution can be found on the network pages at www.debt-on-our-doorstep.com

Aim: The Association seeks to end extortionate lending and ensure universal access to affordable credit and other financial services.

Objectives:

- Publicise the extent and impact of extortionate and predatory lending on low-income groups.
- Lobby parliament, assemblies and other decision-makers to end extortionate lending.
- Research and promote models of universally affordable credit and other financial services.
- Provide a platform and voice for people on low incomes to comment on the causes and impact of debt on our communities.

For the period 1st April 2007 to 31st March 2008 the following charges will apply:

Membership

Statutory organisation £150
 Large voluntary organisation £100

Small voluntary organisation £30

Community groups £10

Affiliation

Individual affiliation £10

Unwaged individual affiliation Free

I can confirm that we support the aims and objectives of Debt on our Doorstep.

I am a UK taxpayer and want CAP to treat this donation as Gift Aid.

 Name

 Organisation

 Address, incl post code

 E-mail

 Phone

 Signature

Please complete and return to: DooD, c/o CAP, Freepost-MR9768, Central Buildings, Oldham Street, Manchester M1 1HH.