

Regulatory Impact Assessment

1. Title of proposals

The Consumer Credit (Disclosure of Information) Regulations 2004

The Consumer Credit (Agreements) (Amendment) Regulations 2004

2. Purpose and intended effect of measure

(i) The objective

The efficient functioning of the credit market is based on the quality and clarity of the information that is transferred between lenders and borrowers. To aid the circulation of information we aim to bring about the provision of upfront, clear information on credit products and the simplification of the format of regulated agreements.

Devolution: The changes will apply in the UK.

(ii) The background

The Consumer Credit Act specifies what information should be provided to consumers, when and in what form.

The existing legislative provisions give rise to confusion amongst consumers about the information they receive from lenders regarding credit products. The requirements need to be revised for the 21st century. Research indicates that many borrowers do not read agreements, and they are usually unaware of clauses that may be to their detriment.¹

The advent of new mechanisms for doing business, primarily the Internet, have further reinforced the need for change. Current legislation prevents consumers from concluding contracts for regulated agreements online. The government wishes to facilitate this, in line with EU law.

¹ DTI's Sept 2003 MORI research, "Consumer Awareness of Credit Issues", reported that around 40% of borrowers only read the main information on the front page of an agreement before signing.

(iii) Risk assessment

Without some regulations stipulating the content and form of information that must be provided to consumers there is a real risk that information will be omitted or misrepresented creating a barrier to the efficient functioning of the market.

Failure in the information provision related to form and content is estimated to cost the economy tens of £millions each year in relation to the overall credit market of around £954billion in February 2004.² This cost is derived from (i) hidden prices (late fees, term extensions etc); (ii) consumers' expenditure in time, stress and money and (iii) the legal bills of challenges (to consumers, the authorities and business). Less readily identifiable costs include a myriad of others such as the increased risk premium, increased consumer transaction costs and the price of over indebtedness that arise because of the purchase of inappropriate products.

Without the flexibility to complete credit agreements online there is a danger that the credit market is unable to adapt to the changing business environment and consumer demands.

3. Options

Option 1: Do nothing but keep the current regulatory content.

Option 2: Impose a new policy comprising obligatory and prescribed pre-contractual information; obligatory and prescribed contractual information including a trio of representative (non tailored) early settlement cost examples; new regulations for add on purchases like Payment Protection Insurance (PPI); minimum payment warnings; improved default communications and regular statements (the latter three items would need to be introduced in a Bill rather than by Statutory Instrument). Also allow lenders the option to complete credit agreements online should they choose to do so.

Option 3: Establish a voluntary code of practice/self-regulation to address the areas highlighted in Option 2 above.

Under options 2 and 3 there is a small risk that consumers will ignore the new and better information and make no changes in the way they purchase products. The effects of this would be that the costs of the reforms would be incurred with very little of the benefits. However, evidence shows consumers do not read their credit agreements in detail due to the way in which the information is presented,

² Egg estimated that consumers pay out £332 million on early settlement each year. Quite a lot of that could be due to poor information provision. This is just one example of the possible high cost of failings in the form and content of credit agreements.

See <http://journalist.egg.com/aboutegg/newsreleases/news2003/2003-06-23/2003-06-23.pdf>.

and the terminology used. For example, 84% of consumers find the language used in paperwork confusing³. Consumer testing of the new credit agreements carried out in April 2004 showed that consumers' general impression was that the new documentation would be much easier to read, however it also highlighted a general reluctance to read agreements.

4. Benefits

Option 1: This option has no benefits.

Option 2: Consumers will be given better information to help them make informed decisions.⁴ The provision of clear, comparable information will raise consumer confidence in comparing and choosing credit products and make the consumer more aware of hidden costs. This will reduce sub-optimal borrowing choices, and many of the associated wider costs such as over indebtedness, stress related illness and resulting lost productivity through time off work.

The Consumer Credit Counselling Service surveyed clients, who had counselling in March 2003, and reported that with regard to their agreement/s: `

44% of respondents said that it did not provide clear information about the rate/amount of interest;

nearly 34% did not think it provided clear information about insurance protection;

nearly 59% did not think it was clear about the consequences of missing payments;

nearly 65% did not think it was clear about fees for late payment; and

50% did not think it was clear about cooling off periods.

This is good evidence that consumers suffer from an information deficit. The DTI Household Survey on over indebtedness in the UK (conducted by MORI) identified that 20% of consumers sometimes have difficulties in meeting their credit commitments. We believe that some of this difficulty arises from not being aware of the potential full cost of the agreements entered into.

The minimum payment warnings and the improvements to missed payment letters should help consumers avoid unnecessary costs, generating savings to the consumer sector as a whole. Similarly, the improvements to PPI should help to

3 DTI's MORI research 'Consumer awareness of credit issues'

4 DTI's Sept 2003 MORI research, "Consumer Awareness of Credit Issues", reported that around 80% of borrowers welcomed more information on their consumer credit rights.

ensure that consumers are fully aware of what they are entering into. This should, therefore, avoid inappropriate policies inadvertently being sold to consumers.

The provision of clearer pre contractual information will allow consumers, should they wish, to shop around and potentially achieve a better deal prior to entering into the agreement. The provision of additional post-contractual information may encourage consumers to switch to cheaper products. The provision of clearer information is expected to be directly attributable to £153 million of consumer savings a year⁵.

Business will also benefit from clearer legislation through reduced legal uncertainty. This is estimated as an annual saving of £1 million.

There will be benefits to both borrowers and lenders from the ability to conclude credit agreements online. Allowing the completion of agreements online is expected to lead to a small reduction in annual costs to businesses. Consumers will benefit from being able to compare loans online, and perhaps find cheaper products online, given that the internet offers a sales channel of greatly reduced cost. We estimate that reduced credit costs will generate around £23 million in consumer benefit each year.⁶

Option 3: This would deliver benefits to consumers whose lenders were members of participating trade associations. However, there are around 100,000 credit license holders but, since the largest trade associations have only several hundred members⁷, the vast majority are not members of any trade association. On the basis that a typical voluntary code will achieve a 50% sign up, at best, we could expect this option to achieve 50% of the consumer benefits in Option 3.

Business sectors affected

Lenders of regulated loans.

Issues of equity and fairness

⁵ It has been estimated that consumers could save £1.9 billion a year in interest payments alone, by switching to cheaper credit cards. This is based on the £52 billion outstanding credit card debt moving from the average interest rate of 15.3% to the average of the lowest quarter of 11.7%. (A similar exercise by Which? in June 2002 also estimated this saving to be in the region of £2 billion). Assuming similar relative savings can be made across all unsecured borrowing, we predict that if just 5% of borrowers switch to cheaper loans and credit cards this will generate a consumer benefit of £306 million a year. This benefit is generated by a combination of policy reforms; regulation governing form and content of agreements is assumed to generate half of this benefit.

⁶ We have assumed that 7.5% of total consumer benefit derived from cheaper credit as a result of the policy measures incorporated in the White Paper, can be attributed to the availability of clear, comparable information online and the ability to complete online.

⁷ The FLA have 188 members. The CCTA have 500 members. The CCA have 500 members. The BBA have 295 members. CML have 144 members. Some of these will be duplicates and not all will offer Consumer Credit Act regulated loans.

The Government believes that this will help sub-prime consumers become more active participants in the marketplace. If agreements can be simplified, and clarity improved, this will benefit both borrowers and lenders. Consumers will have a better understanding of the terminology, making them more inclined to approach official lenders, and less vulnerable to unfair deals.

Allowing the completion of agreements online will introduce an alternative distribution channel. However, it is likely that there will be a proportion of consumers who do not have access to the internet and who would, therefore, be unable to transact online. On the basis that this form of sales channel is likely to offer cheaper products, this could be considered to be unfair to a sector of the population. The risk of personal identity fraud is expected to increase somewhat as a result of individuals being able to complete agreements online. However, the potential detriment is likely to be outweighed by the general benefit afforded by the opening up of the financial services market for internet transactions. An additional benefit of the proposals is that it will be possible to conclude agreements by other electronic means such as the telephone. This means that most consumers will benefit from a wider choice of channels to use when purchasing credit.

5. Costs

Option 1: No additional cost

Option 2:

Transitional Costs

Transitional costs from the reform of the form and content of agreements are estimated at £163.4 million⁸. This is the one off cost to business of redrafting and printing agreements to reflect the new regulations. This consists of legal costs, management time, administration costs, printing costs and IT development and installation costs. If lenders were provided with a sufficient adjustment period, trade associations could provide template agreements for their members - as happens already - which would substantially reduce costs.

Under this option all lenders would be required to adhere to the legislation rather than the 50% take up expected under the voluntary codes in option 3. Therefore the transitional costs will be higher under this option.

⁸ This is based on a cost of £5,000 to each small lender, £25,000 to each medium sized lender and £100,000 to each large lender. Cost information was taken from consultation with industry.

The reform to regulations governing online transactions are not expected to impose any costs on business as it will be for individual lenders to choose whether or not to sell credit products online.

Compliance Costs

Compliance costs across the industry from the reform of form and content agreements are estimated to be fairly low in relation to the transitional costs. Whereas the changeover costs are expected to be relatively high, owing to the factors outlined above, once the content and IT system changes have been made, we expect ongoing costs to comprise of purely administration costs. This consists of annual statements for all loans and decreased revenues through fewer default/missed payment fees as a result of the statements. There may also be small increased costs in ongoing printing costs due to the increased volume of information which will be provided to consumers, both within the agreements and in the pre contractual information.

There are no compliance costs for the reform to regulations governing online transactions, as it will be the decision of the individual lender whether or not to offer this service. However, for those who do choose to offer online transactions there may be an increase in business risk from the increased possibility of fraud, in particular, identity theft (applying for credit products in someone else's name). Identity theft can be stressful for the victim and this cost has been considered.

Option 3:

Transitional Costs

The costs in terms of legal advice, redesign costs, reprinting costs, IT development and installation costs, management time and administration costs would be the same for a member of the voluntary code as for a regulated lender under option 2. Under option 3, these will be borne by each member of the voluntary code, which is assumed to be 50% of all lenders. Therefore the transitional costs are estimated to total £81.7 million. If lenders were provided with a sufficient adjustment period, trade associations could provide template agreements for their members - as happens already - which would substantially reduce costs.

Compliance Costs

Compared with option 2 there would be the additional cost of advertising the code of conduct – particularly in trying to reach the majority of license-holders who are not members of trade associations. It is estimated that the ongoing advertising cost in this instance would be £500,000 a year.⁹

⁹ Estimate based on prior experience of quality mark and good garage scheme

The compliance costs from issuing annual statements and lost revenues through fewer default/missed payment fees are assumed to be the same for a member of the voluntary code as for a regulated lender

(ii) Other costs

None.

(iii) Costs for a typical business

This regulation should have a minimal impact on the costs of larger lenders because these lenders are routinely redrafting and re-printing their printed material. They are likely to have the necessary legal and IT staff in-house, and can also recoup these costs more quickly. With an adequate transition period, their additional costs should be relatively small.

For SMEs who can make use of trade association templates, costs will be negligible (with an adequate transition period).

Transitional costs may, therefore, disproportionately fall on SMEs without access to trade association templates, and who were not planning to revise their publications. However, we do not envisage that SMEs will find these one off costs unaffordable or that these costs will place them at any significant competitive disadvantage.

6. Consultation with small business: the Small Firms' Impact Test

Liaison will take place with the Small Business Service and SME lobby groups such as The Alliance of Independent Retailers and Businesses; The Association of Independent Businesses; The Federation of Small Businesses; The Forum of Private Business; The Independent Food Retailers Confederation and The Union of Independent Companies. They will raise any particular problems where the possible changes may impact adversely on their SMEs.

The Consumer Credit Association have commented that they provide template agreements for their members and these can prove a great cost saving. They sell around one million each year. There would also be related one off costs for sending a revised manual to all members which would be £10-15,000; similar action for laminate instruction cards would total £15,000 and training would amount to £25,000. Such costs spread among the 500 members would amount to an average of just under £2,000 each to be spread over their average of 6,000 customers.

7. Competition Assessment

The competition filter was carried out on the market for the amendments to be made to pre-contractual information and agreements and was found to be unlikely to raise competition concerns. The market is characterised by a multitude of lending firms of different sizes and we do not envisage that the changes will impact disproportionately on any particular firms, other than illegal lenders. Whilst we do realise that smaller firms may have slightly higher costs, we do not expect this to be large enough to influence their operations and they should prove more nimble at making the necessary changes. Any change in the composition of the official lending market will be the result of competitive forces, but will affect small, medium and large firms equally.

8. Enforcement and sanctions

Enforcement of Regulations made under the Consumer Credit Act is largely a matter for local authority Trading Standard Departments. The Office of Fair Trading also has an enforcement role and a duty to monitor the working of the Act.

There will be a non-recurring introductory cost as the OFT, local authorities and Citizens Advice Bureaux train their staff in the new regulations. With such fundamental legislation being changed it is likely that most staff will require some training. The publicity around the time of the changes may also generate an increased demand for advice.

Recurring costs should be capable of being absorbed within existing budgets given over to providing general advisory services.

9. Monitoring and review

Feedback will be obtained – during, but mainly after, a few years of “bedding in” - from Trading Standards, CABs and business over the effectiveness of the new regulations and whether avoidance or evasion has been attempted. Corrective measures can then be pursued, if necessary.

10. Consultation

(i) Within government

Office of Fair Trading
Office of the Information Commissioner

(ii) Public consultation

We have consulted widely both within the Over indebtedness Task Force work and via our CCP Focus groups over the past 2-3 years. In December 2003, there was a 14 week consultation which contained an indication of a draft statutory instrument. Throughout all periods there have been meetings and on-going

communications with lenders, consumer representatives and trade associations to discuss the impact of proposals in more detail. The policy will be implemented by means of secondary legislation which will be laid in June 2004.

11. Summary and recommendation

The proposed information changes should make it possible for consumers to better understand the products on offer and make better choices as a result. Better post-contract information will have a similar effect and will allow the consumer to keep abreast of market developments and to make better informed decisions on how best to manage their debts. Improved knowledge should help minimise the possibility of antagonistic discussions taking place between lenders and borrowers after agreements have been signed.

Lenders will also benefit where more confident and empowered consumers prove ready to take on new debt without fear of any “hidden catches”.

Overall, the proposed changes are a proportionate response to the information deficit issues raised in our earlier work and take account of the valid concerns raised by the stakeholders.

The benefits should be delivered in proportion to the costs. We recommend that option 2 is implemented.

Option	Total cost per annum	Total benefit per annum
1	Nil	Nil
2	<p>Total transitional costs £163.4 million, of which:</p> <p>Small firms £2.25m Medium sized firms £31.6m Large firms £129.5m</p> <p>Total compliance costs Are estimated to be very small in comparison. These mainly stem from a possibility of an increased number of printed pages per agreement at additional printing costs and administration costs of providing regular statements to borrowers.</p> <p>Online lending transitional costs:</p> <p>Individual lenders will decide</p>	<p>Total benefits £177.95 million annually</p> <p>Better decision making leading to cheaper credit for consumers £153 million</p> <p>Reduced compliance cost for business from clearer regulation £1 million annually</p> <p>Reduced credit costs for consumers from online agreements £22.95 million</p> <p>Reduced compliance costs to business from ability to complete agreements online £1 million annually</p>

	<p>whether it is profitable to offer online lending.</p> <p>Compliance cost:</p> <p>Individual lenders will decide whether it is profitable to offer online lending.</p> <p>Possible cost to consumers: The ability to conclude credit agreements online may increase the incidence of a type of fraud known as identity theft. This can have costs in terms of stress for the victims.</p>	
3	<p>Total transitional costs £81.7 million (50% of those under option 2)</p>	<p>Cheaper credit for consumers £76.5 million (50% of the benefits expected under option2)</p>

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs

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Gerry Sutcliffe MP, the Parliamentary Under-Secretary of State for Employment Relations, Competition and Consumers, Department of Trade and Industry

Contact point: CCP5, Consumer Credit Policy Team.
 Department of Trade and Industry, 1 Victoria Street, London, SW1H
 Tel:02072153818
 Consumer.Credit@dti.gsi.gov.uk