

The Community Development Finance Association (**cdfa**) is pleased to respond to OFT's review of high-cost credit.

The **cdfa** is responding on behalf of its 71 members comprised of Community Development Finance Institutions (CDFIs). CDFIs are non-commercial social enterprises which deliver an appropriate financial service to those in greatest need. CDFIs serve three markets: third sector/social enterprise; small- and micro-business; and personal/consumer, providing credit where access to finance has been denied by mainstream financial institutions. Our response has been developed via direct consultation with the membership and also included a representative sample of our members' input to the consultation.

### **Overall position on high-cost credit**

Although high-cost credit can be crudely understood as the free market at work, there are several facets of the credit market in the UK that create inequitable conditions for many disadvantaged communities and groups. But the supply of unmet demand for credit by high-cost debt demonstrates market distortions that should be corrected as part of Government's financial inclusion and other socio-economic policy goals.

Despite several years of relatively low base rates, and an historically low rate at the moment, there has been explosive growth in high-cost consumer debt which some say is merely a response to a legitimate demand for unmet financial services.

However, the increase in market share of high-cost providers, in fact, caused by the following market asymmetries:

- **Market imperfection:** Mainstream providers unwilling or unable to serve riskier consumers often leads to no alternative but to take on high-cost debt. This lack of credit options creates a marketplace whereby monopolistic (high-cost) behaviour thrives.

**Possible remedy:** Credit markets operating between mainstream and high-cost lenders must be further developed and supported; Increased support of alternative accessible and affordable credit, such as that offered by CDFIs, must be secured in order to fill the gaps in the market.

- **Access limitations:** In some cases, there is no discernable alternative to high-cost credit providers. Incomplete geographic cover or lack of access to other channels (e.g. internet) by mainstream or alternate affordable credit providers leaves many without real choice.

**Possible remedy:** Ensure access by all of the wider range of credit options.

- **Education failures:** The finance sector as a whole is one that is easily misunderstood by people across the board. Compounding this problem, transparency and disclosure by high-cost providers may be incomplete and therefore misleading. Consumers purchase high-cost debt without full knowledge and understanding of real costs and consequences.

**Possible remedy:** Compel full disclosure and practical, worked examples of products offered; Total Charge for Credit must be revealed and explained; Provide consumers with comparisons of all credit options available

- **Information deficiencies:** The search costs of finding adequate and appropriate credit for potential consumers of credit may be high; Establishing a realistic and comprehensive inventory of credit options and of alternatives to high-cost credit may be difficult for some consumers.

Possible remedy: Financial inclusion outreach programmes; marketing and communications strategies.

The services that financial institutions provide must be affordable and should not exploit the urgent need for money that many low income households have. At the present time, borrowing money in many deprived areas means paying interest rates of between 300% and 1,000% APR. This is not a responsible way to meet the credit needs of poorer households and is causing long-term damage to individuals and communities.

### **Selected, representative input from cdfa members**

Member comments relate to personal lending for business purposes as well as for purely consumer purposes.

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A.

“What is the right charge for credit?” From a CDFI perspective much depends upon the source of core funding vis-à-vis the prime objective.

If the sole intention is to help the disadvantaged, then the aim should be to charge as little as possible. However for many reasons – be it cost of their own funding, overheads, etc., never mind the risk/reward aspect – it may well be for many CDFIs necessary to seek interest rates notably higher than that available through mainstream sources. Is there any point lending capital at rates which impact detrimentally upon the sustainability of the lender? Unless alternative income streams are available and/or the relevant management are happy to accommodate such a situation then the answer is likely to be – no.

Often the argument is made to suggest that despite what may be considered high rates of interest these same rates pale when set against what can be and is charged by the high-cost and less-than-legal elements in society.

Any attempt to control interest rates and/or additional charges would seem to be an impossible task. Where competition exists the market will find its own level, where competition is minimal then organizations will charge what the market will bear.

Unfortunately the term ‘beggars can’t be choosers’ is true when dealing with those who cannot access credit through the usual routes. Education has its place as does better information, and the lending process may need to be considered but any attempt to control the cost of credit, in my view, is likely to meet some very difficult and likely impossible hurdles.

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B.

Education (point 6) is extremely relevant with people not knowing what they are getting into. However, if they have no other access to finance and someone turns up on the doorstep with cash, what other choices do they have? It then becomes a vicious circle with no availability of funds for future needs as cost of current debt too high.

Point 12 – payment protection is all very well but as long as the cost of provision is not in itself exorbitant.

Point 14 & 15 – open information of indebtedness needs to be undertaken. However, historically in the US they had all lines of credit available for lenders to see so that assessment of more debt was very transparent: e.g. all store cards, credit cards as lines of credit were shown which allowed lenders to see what the potential maximum exposure might be if they were all drawn and therefore again lead to a better assessment of new borrowing requests.

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C.

In our case we do not do what is perhaps considered as personal lending because it is associated with the start up of a small business. In fact the loans we give are personal and not business loans. The clientele are generally people on low income, unemployed and financially inactive. They have little or no security to offer. The products through which they can access credit are restricted. In the absence of CDFIs which understand the circumstances of this community and reflect these within the terms of any lending, clients are often forced toward high-cost credit which in itself becomes a barrier to the survivability of their business rather than a tool to remove or address a barrier to finance which is essential if the business is to become established.

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D.

Some CDFIs take the view that the risk is greater therefore the interest charged is legitimately higher. Our view is that if the loan does not reflect the individual's current economic background and balance this with the overall potential to provide a positive contribution to the economy and as such deals with the credit as a purely commercial transaction either less people will be persuaded to access high-cost credit or those desperate enough to do this will increase the likelihood of the failure of their business because of the added financial demands placed upon the business particularly in its formative period.

Whilst there is a place for such loans there is also a need for recognition of other CDFI activity which offers lower cost credit to potentially sound businesses. The rate of return through hidden savings with health care and visible savings through contributions to NIC/PAYE and benefit savings can produce an overall payback in under a year, with ongoing savings over future years. Segregation of the benefit across various government departments means it difficult to present an effective funding argument to any one dept. Loans of this nature do not neatly fit business products or personal lending and this should be recognised within the current consultation.

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E.

The key issue for us is the proliferation of commercial money shops in deprived areas openly promoting ridiculous APRs (e.g. Oakam, 442%.) Market supply and demand? Yes. Tackling exclusion, disadvantage and poverty? No!

Slightly off topic, its unfortunate that, locally, these money shops are all to often adjacent to the expanding chains of bookmakers following deregulation in that sector.

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F.

The mention of payday loans is very relevant. One area not mentioned is the increasing use of opportunities to charge introductory fees usually fronted by what looks like a fairly typical loan promotion leaflet but I imagine this is out of scope.

G.

I far as I am concerned the single most important factor in all this is that there must be a fairer and more appropriately priced alternative in the market to prevent the less well off/informed resorting to these unscrupulous sources of lending. I.e. if the CDFI movement were better financed we could all provide a similar and fairer scheme across the country.

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Our CDFI provides interest free loans. Having an interest free loan is no guarantee of success but it does increase the chances of success and enables people who would not normally be able to borrow money at any price (i.e. poor credit rating; lower income bracket; long term unemployed) the chance to achieve and regain an entry into the world of work, and in turn contribute to the economy.

Although we are a "small fish" in the world of lending, that doesn't mean that our model could not be duplicated throughout the country with equal success. Perhaps it would be possible for major lenders to offer a tiered system of lending, especially for business and industry working hand-in-hand with an organisation such as ours that offers interest free loans + low interest loan (the most that we loan is £25,000.00 over three years) but an additional £25,000 at a low interest rate could make an enormous difference to business expansion, throw in a Government Grant of equal measure and this might just kick start the economy.

Enormous interest rates cripple and stifle business expansion leading to greater unemployment. We do not see ourselves as in competition with the banks; in fact we use their expertise along with Solicitors and Accountants to assess the Loan applications we receive, accredited Business Advisors are on hand to support and advise the businesses throughout the lifetime of the loan. We take our moral responsibility to the borrower very seriously and this is reflected in the success rate of repaid loans and new companies continuing to trade.

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H.

One view is that because the risk is greater therefore the interest charged is legitimately higher. However, the loan must reflect the individuals economic background, and must be balanced with the overall potential of providing a positive contribution to the economy. If the loan is dealt with as a purely commercial transaction, as many high cost credit suppliers operate, less people will be persuaded to access high cost credit. Those that do take a loan based on purely commercial factors, without examining the more specific personal factors, are likely to end up defaulting or creating added financial demands and greater debt problems.

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## Conclusion

From the CDFI perspective, one of the primary issues at stake is the lack of adequate, affordable and universally-accessible credit.

Regardless of how the problems inherent in the relatively unregulated high-cost credit industry are remedied, one of the solutions must include the expansion and positioning of a nationwide network of CDFIs and other providers of alternative, affordable credit. Unless and until this gap between mainstream and high-cost providers of credit is corrected, some consumers in the UK will be forced into the hands of high-cost creditors, legal or otherwise.

We appreciate your consideration, and we are at your disposal for further consultation on this issue.



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