

Consumer Panel response to Public Consultation on Responsible Lending and Borrowing in the EU

The Financial Services Consumer Panel was established under the Financial Services and Markets Act 2000 by the Financial Services Authority to represent the interests of consumers. The Panel is independent of the FSA. The main function of the Panel is to provide advice to the FSA, but it also looks at the impact on consumers of activities outside the FSA's remit. The Panel represents the interests of all groups of consumers.

This is the Panel's response to DG Markt's Consultation Paper on Responsible Lending. We welcome the Commission's initiatives in this area as we believe that not only does irresponsible lending impact badly on individual consumers, but its impact on the financial system more broadly is felt by all consumers. It is therefore imperative that firms engage in responsible lending practices in order to maintain financial stability; reduce consumer detriment and create a financial system which works in the interest of all consumers. We believe strongly that any Commission proposals for harmonisation need to be based on a high level of consumer protection, and provide minimum (not maximum) harmonisation.

Responsible lending requires firms to take steps to ensure that products sold are appropriate to consumers' needs and their ability to repay. We do not believe that lenders always take reasonable care in making loans or advancing lines of credit. Indeed, it has been common practice on the part of firms to extend unsolicited offers of credit to consumers on a regular basis. This has led to individual consumers taking on more debt than they can comfortably afford in some cases and has been a significant cause of consumer detriment in the UK.

As the paper notes, there are two aspects to responsible lending. One aspect is whether the product itself is inherently suitable, and if it is, whether the product is suitable for individual consumers. The system of financial regulation which has prevailed to date has encouraged innovation with the result that there is a multitude of products available. However we have seen that not all innovation has been positive and products have been developed which are complex and risky for both consumers and firms. We therefore welcome the debate on the suitability of products and product design. There are inherent risks in mortgage loans which reflect and high loan to income multiples. Self-certificated loans are also a source of risk, as are some of the products which are used to fund buy to let properties. As a high level point however, we believe that the real issues is whether real affordability checks are in place, rather than questioning the continued existence of such products.

We hope that that the public debate in the UK on the future of these products will lead to more responsible lending practices on the part of the lenders and the intermediaries who arrange such loans.

It is also essential that lenders clearly represent the terms and conditions of the loan and the rate of interest which prevails in order that consumers can make a reasonable assessment of whether they can afford the repayment terms. We are not satisfied that such information is always clear, fair and not misleading and we would support action to encourage the provision of clear information and we note the efforts that the EU are making in this regard. In particular we would like to alert potential borrowers to the risks that would occur in the event of default so that they can consider properly whether the product they have chosen is suitable for them.

We look forward to seeing whether the Consumer Credit directive leads to better protection for consumers. However, the directive does not extend to mortgage lending which is of course a prime area of risk to the consumer. There is therefore a need to consider the risks emanating from the mortgage market in some detail and we are pleased that the UK Financial Services Authority is currently reviewing the rules that regulate the UK mortgage market. Similarly we would like to see some consideration given to tackling the risks pertaining to second charge lending and equity release, both of which may cause considerable detriment to consumers and which fall outside the scope of the directive.

We note the emphasis on financial education as a means of encouraging responsible borrowing on the part of consumers. Whilst we support measures intended to raise the financial capability of consumers, we firmly believe that it is the behaviour of firms which is the primary source of consumer detriment, and that financial education should not be viewed as a substitute for effective regulation in ensuring fair outcomes for consumers.

Our detailed answers to the CP's specific questions are given in the attached Appendix.



NICK LORD
Financial Services Consumer Panel

31st August 2009

APPENDIX

1. Do you have evidence of misleading or unfair advertising or marketing practices with regard to mortgage and consumer credit?

We see repeated evidence across the industry of financial promotions which fail to meet the required standards concerning clear, fair and not misleading advertising. Where mortgage promotions promote attractive opening rates, it is crucial that these promotions do not mislead consumers with regard to the costs that they incur, e.g. extended tie-ins with high redemption penalties and high arrangement fees. We have encouraged the FSA to be prepared to 'name and shame' those firms that do produce misleading promotions as we believe that this would encourage better behaviour on the part of firms when designing advertising and promotional material. We support proposals to require regulators to publish complaints about misleading or unfair advertising when they are received and to rule on them within a reasonable period.

2. What are your views on the development of risk guidelines?

We welcome initiatives which enable consumers to be better equipped to decide for themselves whether a product is suitable for them and meets their needs. In principle therefore we welcome the development of risk guidelines where they would enhance a borrower's ability to make such judgments. We do, however, believe that consumers will always lag behind product providers in terms of knowledge and understanding, particularly given increasing product complexity.

3. In your view, are there certain credit products that are inherently unsuitable for sale to retail borrowers? Would you welcome a set of standardised or certified credit products to be offered to consumers?

There is always the potential that a product may be designed which might not be suitable for retail borrowers and we expect firms and regulators to take action to ensure that such products are not then made available to borrowers. In the UK there are a large number of mortgage products on offer and there will be appropriate and suitable products available which meet the needs of the vast majority of individual consumers.

Due to the information asymmetry which exists between firms and consumers, we believe there is a case for considering a range of simple, straightforward products. We think many consumers would find it easier to make appropriate choices from a more limited range of products. In this market, excessive choice does not necessarily work in the consumer interest. We believe that there is merit in developing

a range of standardised and well understood products in the mortgage market.

- 4. Do you consider that mortgage lenders and credit intermediaries should always perform credit worthiness and/or suitability assessments before granting consumer and mortgage loans? For mortgage credit, what are your views on the criteria to be used in assessing suitability such as loan-to income ratios or loan-to value ratios?**

We believe that firms should always be responsible for assessing the credit-worthiness of individuals and their ability to repay, before they extend the offer of a loan. When borrowers go into default firms will inevitably recoup the cost by inflating the charges on those customers who are meeting their obligations. We believe that a robust approach to responsible lending will generate a competitively priced and fair market for consumers.

We recognise that there are risks associated with those products which have high loan-to income and loan-to-value ratios. However, we believe that there will be circumstances where such products are appropriate and meet the borrower's needs. We believe that if the lender is lending responsibly; and the risk is correctly priced; and the consumer wants the product; then such products would be made available. We are concerned that withdrawing such products would have a detrimental effect on social mobility and the free movement of labour.

- 6. Do you think that these advice standards would be appropriate in an EU context? Are there others that should be considered? What would be the most appropriate means to introduce and enforce the application of advice standards?**

We believe that the advice standards articulated in the document represent a clear set of principles which would support responsible lending. We believe that member states should ensure that regulators across the EU ensure that their regimes reflect and support the discharge of these principles.

- 12. What would be the most appropriate way to address potential conflicts of interest, particularly with regard to fee/bonus/commission structures? Should any measures in this regard apply to bank client-facing staff as well as intermediaries?**

In the UK the FSA has embarked on an ambitious retail distribution review with the intention of removing commission bias from the market for retail investments. We believe that this methodology could be used to remove bias from other areas of the financial services industry. We also advocate a level playing field with bank client-facing staff as well as intermediaries.

13. What are your views on the registration and supervision of credit intermediaries?

We are in favour of firm supervision of credit intermediaries . Intermediaries play an important role in ensuring whether lending is affordable by the borrower and the supervisory regime needs to reflect this in order to prevent over-indebtedness.

14. What are your views on prudential and professional requirements for credit intermediaries (such as minimum capital, professional indemnity insurance, educational or professional qualifications)?

We believe that prudential requirements are an important tool in ensuring that consumers are not vulnerable to poorly managed and capitalised firms. We also believe educational and professional qualifications should be set at such a level as to raise the quality of advice and inspire more consumer confidence. If credit intermediaries profess or aspire to be 'professionals', then their qualifications need to reflect this.

15. How do you think the activities of credit intermediaries could be brought within existing complaints and out of court redress mechanisms?

Credit intermediaries need to be covered by appropriate dispute resolution provisions as they are in the UK by the Financial Ombudsman Service.