

Protecting Low Income Borrowers in the Credit Crisis

Myths and Truths: Capping of interest rates for home loan companies

A report by

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Myths and Truths: Capping of Interest Rates for Home Loan Companies

1. *Industry myth – Our company offers interest rates much below what loan sharks are offering so we are taking business away from the illegal money lenders.*

Truth – The benchmark companies should be using is what credit unions, banks and building societies are doing. If we are using violent criminals as the benchmark for justifying high lending rates then this shows the serious flaw in the marketplace. To justify 10,000% rates they are comparing themselves with illegal money lenders not legal institutions.

2. *Industry myth – Credit card companies and other high interest businesses can quite legitimately offer higher interest rates in order to make a profit on lending to “higher risk” customers.*

Truth – Credit unions and many banks and building societies make a profit lending at reasonable rates, with credit unions usually offering loans between 10-30% APR – a much more affordable payback rate.

A £500 loan with Leicester's Credit Union, Clockwise, repaid over 60 weeks costs only £573.20 (payments of £9.60 per week) compared to £855 from Provident Financial (payments of £15 per week for 57 weeks), or £1,066 from the same company if similar weekly payments of £10 per week were made - in which case the borrower would need to maintain these for the longer period of 106 weeks.

3. *Industry myth - If mainstream banks aren't prepared to lend money to 'higher risk' customers, and you remove the home credit tier, the only alternative is loan sharks.*

Truth – The whole of the legitimate lending sector – for example banks, building societies and credit unions – offer a much better service than high-interest lending companies, presenting a more secure and safe environment for people with money problems to turn to.

In any event around 50% of people using loan sharks have actually had access to home credit lenders in the previous 12 months and it hasn't prevented them from turning to illegal sources of lending. In some cases, people are using both legal high cost lenders and illegal lenders.

4. *Industry myth – Door-to-door lenders offer a convenient and affordable lending service which helps people to 'make ends meet' from one week to the next.*

Truth – We are letting people move from being “welfare dependent” to “credit dependent”. Too often we see households rolling over loans to pay off previous loans, trapped in a cycle of increasing indebtedness and reliant upon a continued source of credit to pay for essential expenditure including food and heating. There is already evidence that lone parents are paying as much as £90 per week from their Income Support straight into the hands of door to door lenders.

5. *Industry myth – We do not agree that the poorest get a bad deal from companies operating in their area. They offer a legitimate business and need to make money like anyone else.*

Truth – It is possible to make money without ripping people off. High cost credit markets are not 'price competitive' – people using them pay over the odds for the service. There is an underlying principle here: that the poorest consumers are treated as second-class citizens and offered inferior conditions by the marketplace, for example pre-payment meters for energy supplies and credit interest charges. This is unacceptable and needs to change. We agree that price caps generally – under normal market conditions – are not a good idea. But the credit market is not a normal, competitive market for people on low incomes and so a price ceiling can work to reduce the cost of credit without driving decent, efficient companies out of business.

6. *Industry myth – It is difficult to implement any substantial changes in this area as there is little money to be made for both businesses and prospective businesses operating in the poorest communities.*

Truth – It is a myth that there is no money to be made in the poorest communities. The books of loan sharks have been shown to be million of pounds and statistics show that around 2.3 million people use high-cost but legal home credit. According to the findings from the Competition Commission's inquiry into Home Credit, excess profits, beyond those to be expected in a competitive market, of over £500 million have been made by door to door lenders since 2004.

We need to create affordable, legal savings and loans in the poorest communities by bringing together a range of legal financial institutions but this will take over a decade to achieve at any reasonable scale under current rates of growth and intervention. To ensure people pay a fairer price pending access to affordable credit becoming available we also need to clamp down on rip off prices.

7. *Fact – The government is taking action to help all sectors of society get through the credit crisis.*

Truth – There is a need for further action. We welcome what the government has done; it is an unprecedented response to help people in times of need. However the one sector of society we still need to address is the very poorest in our communities.

The government is quite rightly helping middle-income consumers to make borrowing for them more affordable, including mortgage repayments. However the poorest, by the nature of their income, are overwhelmingly excluded from this help and specific action is needed to help them obtain access to affordable credit at a fair price and prevent them from falling into debt and credit dependency.

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