Responsible lending:
An international landscape

November 2013

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About Consumers International

Established in 1960, CI is the world federation of consumer rights groups. Our goal is to ensure that consumer rights can never be ignored. With over 240 member organisations spanning 120 countries, we serve as the only independent and authoritative global voice for consumer rights. We are a registered UK charity.

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Introduction

Responsible lending: An international landscape

This report presents a picture of lending practices and policies around the world from the consumer perspective, drawing on the experience and knowledge of Consumers International's (CI) Member organisations.

In developing the report, we asked authors from CI Member organisations in 14 countries[1] to choose an aspect of lending that is particularly relevant to consumers in their country and provide a consumer perspective on regulation and its implementation, as well as actual lending practices. CI's role was advisory with regards to the content and general outline of each chapter, giving CI Member organisations the space and opportunity to have their voice heard, and to elaborate on issues of their choice as per importance for consumers in their countries.

In addition to these contributions, we have worked with our Members to develop a set of CI recommendations for responsible lending. These recommendations set out the policies and practices that we believe are needed to ensure that lending benefits consumers and minimises the risk of abusive practices and over-indebtedness.

Responsible lending

Credit and debt are key issues for consumers around the world. Access to credit can help consumers to absorb the cost of an expensive item over time, or to cope with unexpected expenditures. However, if consumers cannot afford to make repayments, either because of a miscalculation in the affordability of the loan, or due to changed circumstances, then levels of debt can become unsustainable, causing anxiety and ultimately hardship as debt repayments usurp funds needed to purchase essentials and possessions are sold at reduced prices, or seized, to repay debts.

Both consumers and providers have responsibilities in relation to credit and debt. The consumer has to make a proper assessment of their ability to repay the loan, and must provide accurate information to the provider so that it can assess the suitability of the loan. Consumers also need to be clear that they have entered a contract that they should honour.

However, the provider also has serious responsibilities. At one level, these responsibilities can be summed up as policies and practices adopted by lenders that seek to ensure a borrower can repay a loan without suffering hardship. This should include an assessment of a borrower's ability to repay the loan, but must also include transparent and fair fees, charges and contract terms, responsible marketing practices, and managing client relations

[1] The countries in alphabetical order are: Argentina, Australia, Belgium, Fiji, Greece, India, Italy, Malaysia, Russia, Slovenia, South Africa, Uganda, United Kingdom, and the US (submitting two chapters on diverse issues).

with respect for consumer rights, including having systems in place to assist debtors in difficulty.

Too often though, what consumers face is aggressive, predatory selling practices pushing expensive, complex products that borrowers can ill afford and do not understand. Disclosures are either after the fact, or hidden in legal jargon in fine print in contracts which consumers are pressured to sign in haste. Rare is the institution that publishes its standard form agreements, clearly explains the terms and puts the pricing structure in the public forum. Therefore, it should not be a surprise that consumers are ill informed of their obligations, or the true cost of loans. In fact, in Russia for example there is no common manner for communicating cost. In other countries, product bundling, varying loan tenures, and opaque marketing practices make it impossible for the consumer to comparison shop. In quite a few countries, credit is also offered without the provider performing a proper assessment of the consumers' ability to repay (eg, USA, Fiji, Russia); in others, unscrupulous providers offer more credit than the consumer actually needs or has asked for (eg, Belgium).

Regulatory responses

Internationally, there is increasing interest in the topic of responsible lending. At the request of the G20, the Financial Stability Board produced a report "Consumer finance protection with particular focus on credit"[2] which includes the results of a survey of its membership on regulatory approaches to consumer credit. FinCoNet, the international network for financial consumer protection, has also included responsible lending in its work plan for 2013/2014. A number of other international initiatives that look more broadly at financial consumer protection also include recommendations highly relevant to credit. These include the G20 High Level Principles on Financial Consumer Protection (2011)[3], the World Bank Good Practices for Financial Consumer Protection (2012)[4] and initiatives such as the Smart Campaign Client Protection Principles.[5]

A handful of countries have also passed legislative and regulatory guidelines on the topic (eg, Australia, Malaysia and South Africa). However, the challenge remains in the detail, the content of the measures and whether the will and resources are available to support enforcement. In both Australia and Malaysia, legislation is still too new to say for certain what the benefits for the consumer will be.

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[2] Consumer finance with particular focus on credit, Financial Stability Board, October 2011, www.financialstabilityboard.org/publications/r_111026a.pdf

[3] G20 high level principles on financial consumer protection, 2011, www.oecd.org/daf/fin/financial-markets/48892010.pdf

[4] Good practices for financial consumer protection, The World Bank, 2012, http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/282884-1339624653091/8703882-1339624678024/8703850-1340026711043/8710076-1340026729001/FinConsumerProtection_GoodPractices_FINAL.pdf

[5] http://www.smartcampaign.org/about-the-campaign/smart-microfinance-and-the-client-protection-principles

In Australia, the regulations have been cautiously welcomed by CI Member Choice, though some concern has been expressed that over-simplistic interpretation could impair access to credit for some.

In Malaysia, in response to debt-laden consumers, the Central Bank limited amounts of credit to no more than double the consumer's monthly income, and numbers of credit cards to two per consumer. It also mandated that the credit assessment should consider net vs. gross incomes when granting credit. Despite these interventions, consumer debt levels are still greater than 80% of GDP per capita; the highest in the region.

In South Africa, the National Credit Act has been in place since 2005, but implementation with regard to debt counseling procedures as a means to rehabilitate the over-indebted does not appear to be making a dent in the problem as some 47% of the credit active population remains *credit-impaired* (and by law unable to take on any more debt).

Even in countries where consumer credit legislation has been in place for many years, for example, in Belgium (legislation since 1991 and modified in 2010), the problem does not really seem to be the absence of legislation, but rather the lack of adequate enforcement. In particular, the Belgian consumer organisation, Test Achats, referenced inappropriate advertising and online sales not in compliance with the law.

Emerging common threads

All of our chapters identify abusive practices that should be of real concern to regulators, however, too often regulatory action has been late in coming or ineffective. A common theme in many of the chapters is the relative lack of concern that governments and regulators have for consumers, concentrating instead on macro-economic issues and prudential regulation. CI's Members highlight cases where government policy appears to support increased borrowing despite burgeoning levels of consumer debt. Surprisingly, this is even the case in countries that have experienced a full-blown financial crisis. Argentina's government, for example, openly encouraged consumers to buy appliances on credit 'for the good of the economy'. Similarly, despite the US mortgage fiasco, the US government has encouraged consumers to spend (as opposed to saving) as a type of patriotic duty.

In several countries, the regulation of the financial sector is also concentrated on prudential regulation to the exclusion of consumer protection, even though weak consumer protection is now recognised as posing a significant risk to the sector and potentially to the economy as well. As CI's Slovenian Member, ZPS, puts it, there is often *supervision without consumer protection*. In Uganda, Consumer Education Trust recounts how, according to the Bank of Uganda (BOU), the BOU serves a (much) higher purpose than protecting consumers, one of which is to fight inflation by keeping interest rates high. Therefore, BOU allowed commercial banks to *retroactively raise interest rates on consumer loans already issued*.

A similar situation occurred in Russia following the 2008 financial crisis. The government responded by freezing loan repayments for the unemployed, however several banks retroactively changed the terms of contracts and increased interest rates and it took two years for new legislation to be introduced to effectively stop the practice.

Recent reforms in the US and UK hold the promise of improved protection for financial consumers but CI's members note continuing problems. CI's US member Consumer Reports highlights the fact that it is still very difficult for US students to calculate the true cost of student loans and many are becoming heavily indebted. And in the UK, the growth of high interest 'pay day loans' has created much controversy. CI's member in the UK, Which? has made a number of recommendations for how the new regulator can address the abuses and promote better alternatives for consumers.

Financial consumer dispute resolution also fails to receive enough attention in many countries. Only a few of the 14 countries that submitted papers have financial services ombudsmen. And, in some cases, like in India, the ombudsman has a restricted mandate because it is only available to customers of licensed banks (with the proposed new legislation, the ombudsmen may be available for microfinance clients as well). In most cases, however, consumers with complaints are left to their own devices – or forced to use the court system to resolve disputes, incurring more costs as is the case in Fiji, whereby heavily-indebted consumers weighted down with monthly instalments on appliances from hire-purchase agreements can ill afford to take matters to a court (and their goods and/or land may be seized and sold through collusive practices before they reach the court).

In this report, only two chapters note the dangers of a stalled market for credit. One example comes from the Indian state of Andhra Pradesh where a crisis in microfinance lending contributed to hundreds of over-indebted micro borrowers' committing suicide. The government responded with interest rate caps, as well as applying burdensome restrictions on collection practices. Microfinance institutions (MFIs) must utilise the local authorities called the 'panchayats' to collect microloan payments on a weekly basis, adding a level of bureaucracy and cost such that many MFIs have stopped serving the poor. CI Member Consumer Unity and Trust Society appeals to the government of India to be cautious to not exclude millions of poor from the financial system.

In Italy the market for credit has stalled for other reasons, but government efforts to stimulate lending have had little impact. CI's Italian Member Altroconsumo writes about how the Bank of Italy has tried to encourage banks to make home loan mortgages by establishing a 50m EUR guarantee fund for mortgages to young consumers who would otherwise not have adequate guarantees. It seems Italian banks either do not want to use the guarantee fund, or do not know of its existence, and consumers are no better off for this effort.

It must be noted that the context for many of these chapters is an economic situation in which consumers are under severe pressure with falling incomes and rising prices. Alarmingly, in several of the chapters submitted, consumer advocates note that consumers are using high-interest, short-term credit to pay for essentials like food (eg, Argentina, Russia and the UK). In such desperate circumstances, the potential for abuse of consumers is multiplied. In fact, in Argentina, the stores appear to reward this behaviour by offering discounts when consumers use their credit cards to food shop. But if the potential for abuse is multiplied, so too is the need for effective regulation.

The role of consumer organisations

On a positive note, the chapters do demonstrate the important role played by consumer advocates who independently and consistently represent the voice of the consumer. There are examples from many countries of the research, advocacy and services provided by consumer organisations that seek to protect and inform consumers and alleviate consumer suffering.

Often, CI Members' activities are seeking to fill the gaps left by governments or regulators, without even a small portion of those entities' budgets. Take, for example, the case of Greece, where personal bankruptcy legislation was passed in 2010, but due to unemployment and the accompanying EU austerity measures, over-indebted consumers are simply too poor to afford bankruptcy filing fees. Thus, the Greek consumer organisation, New Inka, has offered pro bono filings for consumers who desperately need help.[6]

Consumer organisations around the globe are also effective monitors of industry behaviour. For instance, initial research by KonfOp in Russia suggests that none of the 20 leading banks posted mortgage annual percentage rate (APRs) on their websites (despite existing regulations requiring disclosure); or in Italy, AltroConsumo's secret shopping research demonstrated that a guarantee fund for home loan mortgages for youth in precarious employment was under-utilised, and thus a waste of government resources.

In short, effective, well-funded consumer organisations have a fundamentally important role to play in supporting the development and adoption of effective consumer protection legislation; highlighting abusive practices and protecting the consumer from being the victim of predatory practices. This is a vital service for individual consumers, the economy and society as a whole.

[6] A potential solution could be to mandate that banks contribute to the over-indebtedness fund based on their previous year's write offs, which reflect their 'contribution' to the problem of over-indebtedness in society, as Belgium has done.

Consumers International: Recommendations on responsible lending

All lenders should seek to ensure that borrowers can repay their debts without suffering hardship and that the financial service sold is appropriate to the borrower's needs and circumstances. This implies an assessment of the affordability of the loan as well as responsible and appropriate product design, provision of accurate and clear information and marketing.

Effective regulation

1. All lenders should be subject to oversight by an effective regulator

- All lenders should be licensed and regulated. In addition, they should meet all statutory obligations and codes of conduct relevant to their work.
- Regulators should have sufficient powers and resources to effectively regulate lenders' market conduct.
- Regulators should monitor data about complaints and levels of consumer debt at the national level and, where applicable, state/regional level and use this information to develop regulation. The generic complaint data, including reports on individual companies, should be made available to the public.
- Regulators should have the power to apply a variety of sanctions appropriate to the degree of transgression, including withdrawal of licence for serious breaches.

Accessible dispute resolution

2. Consumers should have access to effective complaint mechanisms and dispute resolution

- Lenders should have effective internal procedures for handling consumer complaints in an appropriate and timely manner.
- Consumers should have access to independent advice if they are concerned that they may have not been treated fairly by a lender.
- Companies should make information readily available about their complaints procedure and independent sources of dispute resolution.
- In the event that consumers are not satisfied with a lender's response, they should have access to expedient, inexpensive and efficient third-party mechanisms for dispute resolution.

Affordability

3. All lenders should make a proper assessment of a borrower's ability to repay

- Before giving credit, lenders should assess a borrower's ability to repay the loan and the suitability of the product based on the consumers' needs and circumstances.
- The assessment should be based on a credible, standard methodology such as Loan to Value or Debt to Income and include income and expenditure, assessing existing credit commitments and leaving sufficient flexibility to deal with unexpected cost.

- The assessment should not be based on a teaser rate or unreasonable assumptions (such as, in the case of long-term loans, unusually low interest rates or major increases in income).
- Regulators shall ensure that appraisers carrying out valuations of immovable property used as collateral are professionally competent and independent.
- Where possible, lenders should verify information that is given to them by the consumer regarding income, expenditure and credit history.
- A loan application should be rejected if the requested loan amount is deemed to be unaffordable, and lenders should detail: the specific reasons for rejection; the specific actions the consumer could take to address the reasons for rejection; and the amount the lender could offer the consumer on the same terms as the loan that they initially applied for.
- Lenders should avoid simplistic or crude assessments that might unfairly deny consumers credit.
- Failure by lenders to carry out due diligence (including credit checks) before lending should lead to loans being invalid.

Credit reporting

4. Credit reporting has a key role to play in responsible lending and should be transparent, available and used to assess a borrower's ability to repay

- All credit bureaus should be licensed and regulated.
- Lenders should be required to share credit data with all credit bureaus to facilitate *accurate and consistent assessments of a consumer's ability to repay.*
- Credit bureaux should be required to publicly state the types of data that they do and do not hold.
- The regulator should widely publicise the cost and process of how consumers can obtain a credit report. Regulators should also provide or facilitate the compilation and public dissemination of independent comparison tables of the data held by all credit bureaux in their jurisdiction, so that consumers can see the different information used to determine their credit rating
- Lenders should provide consumers with the name of the credit bureau(x) used to assess their credit application and identify any gaps in the agency's data.
- Lack of positive data should not disqualify a consumer from accessing credit.
- A consumer's credit score should not be damaged as a result of a consumer making an enquiry.
- Sensitive consumer data must be protected and privacy issues respected. Relevant regional or international principles covering privacy should be applied.
- Credit bureaux should have quick, clear, and accessible mechanisms for consumers to check the data held about them, to correct errors and to resolve issues when there is a dispute.
- Credit bureau complaint data should be regularly monitored by the regulator. This evidence, and the insight derived from it, should be used to identify consumer detriment and inform changes to policy and practices to address those problems.

The generic complaint data, including reports on individual bureaux, should be made publicly available.

Product and service

5. Product design and account management should facilitate responsible lending

- Consumers should give their informed consent and have a 'cooling off period' during which they can change their mind without incurring any cost before any long-term loan agreement takes effect regardless of the channel used to apply for the loan.
- Credit contracts shouldn't require consumers to waive their basic consumer rights. Unfair contracts should be voidable.
- Where there is concern about high rates, competition authorities should investigate whether markets are competitive and, if required, take action to promote competition. If the market fails to keep rates at a reasonable level, regulators may consider the use of rate caps. Other fees and charges should be able to meet a 'reasonableness test'.
- Consumers shouldn't be encouraged to borrow more to maintain preferential rates or offered unsolicited increases in their credit limit.
- Consumers should not be inappropriately encouraged to rollover short-term loans in a way that is unsustainable, unaffordable or otherwise harmful.
- Lenders default position should be that repayments are allocated first to balances that attract the highest interest rate or are most effective in reducing overall costs.
- Products should meet a comprehensibility test, including a requirement that additional complexity delivers genuine consumer benefit.
- Lenders should train staff in how to identify and help consumers who are experiencing difficulty in making repayments and offer practical solutions, with clarity on any additional costs. Lenders should make information about independent debt counselling available.
- Tying should be banned: the consumer should always have the right to buy ancillary products from alternative providers and lenders should be required to clearly communicate this to the consumer.
- Regulators should take effective measures to protect consumers against the exchange rate risk of foreign currency loans. Informing consumers about the risks of foreign currency loans is not a sufficient measure to protect them.
- Consumers should always have the right of early repayment. Early repayment compensation, if any, should be calculated transparently and fairly. Consumers should be informed about their right to early repay and the amount of the expected compensation already at the pre-contractual stage.

6. Information should be provided in a manner to help the consumer make an informed choice

- All lenders should provide information that is clear, sufficient, reliable, comparable and timely for the consumer to compare different products and make an informed decision.

- Regulators should publish comparative tables with contract terms, interest rates and fees or support their publication by an independent body. Examples should be given to demonstrate how any charges and interest rates could vary over the course of the contract.
- All lenders should use standardised key information documents with comparable information on interest rates, such as monthly and annualised percentage rates (APRs), as well as illustrations of typical payments in cash terms over a given period.
- All lenders should use a standardised method for calculating APR.
- Loan agreements which have not respected the above terms should be voidable.

Staff targets and incentives

7. Lenders' business practices should incentivise customer service not sales

- Remuneration of lenders and intermediaries should be product neutral. Instead, incentives should be linked to providing quality customer service. All inducements in kind to credit intermediaries should be banned.
- Lenders should be liable for the quality of the loans they make, even if the loans are sold to third parties.
- Regulators should ensure consumers who are miss-sold financial services are fully compensated and lenders face sufficient penalties to discourage further offences and that these penalties are made public.

Responsible marketing

8. Marketing and advertising should not encourage irresponsible borrowing

- All marketing and advertising of financial products and services should be accurate and truthful and consistent with relevant regulations. There should be a specific marketing code for financial products enforceable with sufficient penalties to deter abuse.
- The objective, tone, content and inference of marketing should be to encourage responsible borrowing.
- All advertising of credit should include a representative price that at least 51% of respondents could expect to get.
- Marketing shouldn't be used to advocate solving debt through more borrowing.

Informed consumers

9. Consumer education and advice should support responsible borrowing

- Basic budgeting skills should be taught as part of the national curriculum and reinforced through public education campaigns that are accessible to all consumers.
- Independently-produced information about what to consider and look out for when purchasing credit should be given to consumers at the point of sale.
- Independent advice should be available for consumers who want additional support in choosing a product.

Over-indebtedness

10. Debt resolution should be available for consumers who have become over-indebted

- Regulators should define over-indebtedness for their jurisdiction.
- Should a consumer become over-indebted as a result of a change in circumstances, they should have access to a fair mechanism to agree a timetable of payments, a temporary break from repayments and interest accruing or a reduction in the loan so that they can reasonably expect to return to a manageable level of debt.
- Regulator should establish or support the establishment of independent debt counselling centres which also mediate on behalf of consumers.
- Lenders should not adopt coercive recovery methods and regulators should have monitoring in place to identify and punish violations.
- If the court considers that the totality of a relationship between lender and borrower is abusive then the terms of a loan should be invalid.

Chapter 1

Argentina: More than a decade of pain for the Argentine financial services consumer

Antonino Serra Cambaseres, Policy Expert, Consumers International

December 2001. The streets of Buenos Aires are in turmoil. Thousands of Argentines are marching in the streets, pans and spoons in their hands, protesting against 'El Corralito' ('The Little Corral', a euphemism for the government-imposed freezing of all bank deposits. People can only withdraw a small daily sum from their banks. Afterwards, all deposits are frozen and those accounts in US dollars are converted into Argentine pesos and devalued. The crisis, the worst in more than 200 years of Argentina's history, forced the President to resign and caused a political tsunami leading to a transitional government followed by new elections a year and a half later.

One of the targets for demonstrators' rage was the doors of commercial banks. They were rhythmically beaten with any piece of metal people could find, with shouts of: "Thieves! Give us our money back!"

Long-term credit during this period was non-existent, and consumers could only use the credit they had in hand: credit cards. Annual interest rates for overdrafts were more than 65%. Families were driven deeper into debt, and subsequently 50% of Argentines dropped below the poverty line.

August 2010. The FIFA Soccer World Cup ends with Argentina defeated earlier than expected. Diego Armando Maradona was the Argentine coach and expectations were high that the team would win. Thousands of Argentines were out on the streets again, but this time they weren't demonstrating, they were in the stores, buying LCD and LED TV sets to watch the matches on the biggest screen they could afford (or not, as the case may have been).

The government launched a plan called 'LCD for all' to encourage consumers to buy their televisions sets with up to 60 months of financing with interest rates that were between 15 and 20%. TVs were in short supply. After the World Cup, and amid the anguish of defeat, many low income consumers realised (belatedly) that they still had to pay for their TVs. And, unfortunately, despite the five-year payment schedule, many realised that they would not be able to afford them. Repossessions started, leaving holes in living rooms and kitchens where the TVs once were. Banks also claimed payments from consumers' salaries.

March 2013. Can I pay my VISA bill with my MASTERCARD? The circle of domestic consumption in Argentina is now a complete, and vicious, circle. After several years (2005-2008) during which personal loans and mortgages were quite easy to obtain, interest rates were more reasonable and the economy more steady; and credit became scarce again. As it is said in Argentina, someone has to pay for the broken dishes; and it seems it is always the consumer who pays.

The government statistics institute reports that the inflation rate is 10%, but the real rate is thought to be around 20 to 25%, and a popular political TV programme recently reported that consumers expect the inflation rate for next year to be around 40%.

More and more often, consumers are financing their daily expenditures – supermarket purchases, medicine, and clothing with credit, and in particular credit cards. And, although the annual interest rates have dropped dramatically since 2001, they are around 35%, which is still very high.

Many retailers have also introduced promotions that give a discount of 20 to 25% if products are purchased with a bank credit card. These promotions are especially common in supermarkets and electronics stores. In the case of supermarkets, the result is that people are commonly buying milk, oil, rice, flour and other basic products using credit cards, and paying for these basic needs in three or more instalments, and with additional interest rates depending on the repayment schedule. Alternatively, they pay the minimum amount off their monthly balances, but continue to pay interest on the remainder.

Is there an economic emergency in Argentina nowadays? Not as was the case in 2001. But now, people are effectively queuing up to pay for the broken dishes in the future; and the danger is that the future is just around the corner.

The dynamics of the financial markets in Argentina are changing, and the landscape has changed dramatically in the last decade. Access to financial markets increased, mainly through the payment of salaries into a bank account, something that 10 years ago was uncommon. Those who now have bank accounts are offered credit cards and other 'benefits', for instance, it is common to receive promotions for insurance, health insurance or an upgrade to 'gold' and 'platinum' cards. But, there is no attempt to initiate a programme of financial education or financial inclusion for consumers. With little knowledge, and even less experience, the consumer path inevitably ends in growing debts and, in too many cases, over-indebtedness.

With an inflation rate that is difficult to control and consumption promoted by the government as a means to revitalise the economy, Argentina is a ticking time bomb. Again, the consumer will be the one standing next to the bomb when it explodes.

Are there any lessons learned from the past? Some, but still not enough to ensure that consumers can breathe peacefully. And among the unlearned lessons is the lack of compliance with consumer protection law.

Research from 2009 conducted by CI in five countries in South America, including Argentina, showed that compliance with consumer protection law in the country was far from optimal. The country report showed that there were several weak points and various breaches that needed urgent action. For example, abusive clauses are common in the contracts that consumers have to sign to open a bank account, or to obtain a credit card. The language in the contracts is drafted in legalese that is too complicated to understand, and it is very difficult for consumers to get a copy of the contract before it is signed.

Transparency of information is another area where no lessons were learned. Incomplete and hidden information was found amongst all the banks surveyed, including publishing misleading information on costs, charges, fees and conditions. Advertising of banking products is equally opaque too.

Not much has changed since the CI study in 2009.

Consumer groups have fought intensely against these practices in class actions, and some of them have obtained a measure of success. Superior courts have ordered banks to refund charges and return fees improperly retained, as well as to compensate consumers for the abuses. Another excellent advance for consumers was the creation of a Consumer Protection Division in Argentina's Central Bank that works to make the market more transparent and accountable. In a recent decision, they ruled that the 'Total Financial Cost', that is the total cost a consumer must pay including fees and charges, must be clearly explained to all consumers prior to a transaction being completed, and that it must also be displayed in bank branches, on web pages, in flyers and in advertising.

In an unpredictable economy such as Argentina's, banks have impressive profits (and thus influence), and much of that profit derives from interest and charges, illustrating that it will be a hard battle to reverse certain revenue generating practices. A report on banks for 2012 states that they earned 21.200m ARS (around 3.700m USD) from interest charges and fees from credit cards, and of that amount, 8.300m (1.500m USD) came from interest, while 12.900m (2.300m USD) came from commissions, issuance of cards, renewals and other concepts related with them.

September 2013. So, in a snapshot, what are we left with? Diffuse images. Lending is again a very difficult and expensive mountain for most consumers to climb. The old adage is increasingly true that banks are open to lend to those who do not need money, but for most people credit is only available through their credit cards with rates varying from 15 to 35% annually. Thus, the decision for consumers is one of two evils: to postpone any borrowing till the winds are more favourable, or risk becoming over-indebted.

No society can grow if credit is not available for those who need it. Prosperity is something that must be a reality for all people because, if not, we are left with inequality. And in the event that everybody is committed to attaining the state of prosperity for all, then all must be prepared to manage that prosperity. Clear rules, adherence to the law and education must be at the forefront of working to improve society.

Chapter 2

The Australian Responsible Lending Act: The verdict is cautiously optimistic for the consumer

Elizabeth McNess, Principal Advisor, Financial Services, Choice

With the transfer of credit regulation to the federal government, Australia introduced national licensing and responsible lending obligations for credit providers and brokers in 2010. These positive obligations directed to credit providers mean that lenders cannot *enter into a credit contract with a consumer, suggest a credit contract to a consumer, or assist a consumer to apply for a credit contract if the credit contract is unsuitable for the consumer*. Consumer groups have largely welcomed the reforms which oblige lenders to demonstrate that the credit is *not unsuitable* for the consumer.

The Australian financial services regulator, the Australian Securities and Investments Commission (ASIC), has established detailed guidance on how to comply with the new obligations. Thus far, there have not been any court decisions based on a breach of responsible lending obligations; as individual consumer's disputes are more commonly addressed through ASIC-approved external dispute resolution schemes (membership in which is a requirement for obtaining a credit licence). However, one of the dispute resolution schemes has recently made a determination based on a financial institution's non-compliance with responsible lending obligations (to be discussed later in this chapter).

To meet the responsible lending obligations, credit providers must:

- Make reasonable enquiries about the consumer's financial circumstances;
- Take reasonable steps to verify the consumer's financial situation; and
- Make an assessment that the credit is 'not unsuitable' for the consumer, based on the previous two steps.

A loan is considered to be *not* unsuitable if it meets the consumer's requirements and objectives, and the consumer has the capacity to repay the loan without experiencing substantial hardship.

In addition to responsible lending obligations, there has been a series of reforms to consumer credit including bans on some fee types; the introduction of one-page fact sheets for home loans and credit cards; improved disclosure about time to repay on credit card statements; the prioritising of high interest bearing debt in credit card repayments; and banning unsolicited credit card limit increase offers. Consumer groups have generally welcomed all of these reforms. The reforms, however, are still relatively new, and not yet widely tested.

Pay day lending – a gap in the obligations?

One area in particular that has escaped testing under the responsible lending regulations is payday lending, or small amount credit, which is an area of growing concern to consumer advocates. Small-amount credit had, until recently, been regulated to varying degrees through state-based regulations (throughout Australia's six states and two territories). Some states have interest rate caps, with and without inclusion of other fees and charges. In March 2013, national price regulation of small amount credit was introduced in Australia and consumer advocates hope to see the same responsible lending criteria enforced in this sector now that it is nationally regulated.

Generally in Australia, it is difficult to access credit for less than 3,000 AUD from a mainstream lender, and consumers are often directed to a credit card. And, as of May 2013, there were more than 15.3m credit card accounts in Australia, with more than 35bn AUD in credit card debt accruing interest at 10 to 20%. For consumers who are not able to access a credit card, or not interested in a credit card, or who have already used their credit card to its limit, the answer to credit needs is often to apply for a payday loan (now called a 'small amount loan'). Payday loans come with significantly higher effective interest rates. Before the recent reforms, the Consumer Action Law Centre estimated that effective interest rates were 400%/annum and higher. While the new reforms do mandate maximum charges, this is still an expensive form of credit.

Estimates of the size of the Australian payday lending industry vary. In 2011, the Parliamentary Joint Committee on Corporations and Financial Services estimated that there was 800m AUD in small-amount credit in Australia. Some credit alternatives are provided by civil society organisations, including the No Interest Loan Scheme and StepUp low interest loans offered by Good Shepherd Microfinance, and Centrelink (government benefit payment) advances. However, these programmes are small scale, and are unlikely to ever replace payday lending.

First cases show how obligations may be used

As mentioned previously, one of the two named dispute resolution schemes, the Financial Ombudsman Service (FOS), recently made its first determination under responsible lending obligations.[7] The outcome in this case highlights the potential for responsible lending obligations to challenge unsuitable credit and unsuitable credit products.

The case involved a consumer lease for an LCD tv and home theatre where the financial services provider (FSP) was not able to provide evidence that it had made "a proper assessment about whether the applicant could meet her financial obligations under the lease". In particular, FOS noted that the FSP also acknowledged that it lacked both:

- Written internal procedures for assessing the applicant's capacity to repay; and

[7] https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/266568.pdf.

- Guidelines for staff as to how to make reasonable enquiries and what information is relevant.

For these reasons, as well as other failings by the FSP, the FOS set aside the rental agreement; released the consumer from all obligations; transferred ownership of the goods to the consumer; and refunded the consumer rental payments made in excess of the value of the goods.

Future determinations from external dispute schemes are likely to have a significant influence on how these new obligations work. However, the full effect of the new obligations will not be known for some time. Consumers first need to take their complaint to their lenders' internal dispute resolution process before they can lodge a dispute with the external dispute resolution scheme. In addition, disputes can be settled, which usually means that the details remain confidential, rather than taken to determination where the full details – including any compensation – are usually made public. The publication of determinations could provide guidance to credit providers regarding acceptable conduct.

ASIC has recently launched its own action on a breach of responsible lending obligations. This action involves 10 consumers who ASIC alleges were given loans that were unaffordable and not suited to their requirements.[8] ASIC has also recently banned company directors and cancelled the credit licence of an appliance rental company that was failing to comply with responsible lending obligations.[9]

Obligations may prevent access to credit for some

Unfortunately, as a result of this law, CHOICE has noted an adverse impact on consumers, in that these regulations are being used as a reason to deny credit. This has particularly been the case with self-funded retirees who often have substantial assets and a sufficient income to meet their needs.[10] Responsible lending laws cannot force a lender to make wider inquiries in its credit assessment, so lenders may choose to have fully-automated (and inexpensive) systems that approve only 'standard' situations. ASIC has updated its guidance on superannuation income, but they cannot force lenders to make wider inquiries, or accept particular types of income.

Thus, while consumer advocates have broadly welcomed the responsible lending obligations, we are keen to see them enforced, as well as tested. Many consumer advocates would ideally like to see responsible lending challenge the structure of small-amount credit. In particular, that the laws are relevant to low-income earners, so that a small-amount loan

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[8] http://www.asic.gov.au/asic/asic.nsf/byHeadline/13 228MR%20ASIC%20commences%20legal%20action%20against%20Cairns-based%20lender%20and%20broker?opendocument

[9] http://www.asic.gov.au/asic/asic.nsf/byheadline/13-235MR+ASIC+takes+action+against+rental+companys+franchisees?openDocument

[10] http://www.choice.com.au/reviews-and-tests/money/borrowing/credit-cards/credit-card-ageism.aspx

could be considered unsuitable, especially in situations where loan repayments mean that a consumer forgoes an essential item. The recent decision by FOS has indicated that “not unsuitable” may be effective in changing practices. However, more suitable small-amount credit options are still needed. The oversight, guidance and enforcement by ASIC will be critical to the success of the reforms.

Chapter 3

An analysis of consumer credit legislation and its impact in Belgium

Danièle Bovy, Policy Officer, Banking Services and Credits, Test Achats

This chapter focuses on consumer credit; but *not* mortgage loans. The Belgian law on credit and consumption was passed on 12 June 1991 and was amended on 13 June 2010 to conform with the European Consumer Credit Directive (2008/48/EC).

The law takes consumer protection into account, even though further improvements could be made because:

- Most of the problems experienced by consumers derive from the fact that the law is not adequately enforced. Lenders and their intermediaries frequently ignore the statute's requirements (especially true for loans given in stores and online to be discussed later in this chapter). Further, advertisements are also frequently not in compliance.
- The providers' obligations to provide information and advice are often ignored.
- The law should elaborate the specific information to be gathered on the consumer's financial situation.
- The timeframe for the Standard European Consumer Credit Information (SECCI) pre contract credit submission should be established so that this document can fulfil its informational role.
- Provider canvassing in public places should be prohibited.
- The regulator should strengthen its monitoring and supervision of the industry.

The measures introduced by this legislation are intended to prevent over-indebtedness. The candidate borrower is regarded as the fragile element in the contractual relationship. Therefore, responsible credit practices are organised around different themes:

Scope of the legislation

Consumer credit is defined as any credit serving some purpose other than that of financing the purchase of a building, and can include instalment loans and sale, the opening of a credit line, or leasing agreement. Current account overdrafts were originally excluded from the law's scope of application, but since 2010 they have been added.

In instances of consumer over-indebtedness, an account overdraft was often the first step in the decline of the consumer's ability to service his or her debts. Integrating account overdrafts into the law was a step in the right direction, and it is now more difficult to obtain them.

Advertising

All advertising for credit products must include the following information:

- Identity of the advertiser, including the address;
- Form of credit proposed;
- Specific conditions linked to the granting of the credit; and
- In certain cases, advertising must include the warning: "Attention, borrowing money also costs money."

The following actions are specifically prohibited in advertising:

- Encouraging a consumer in financial difficulty to borrow;
- Highlighting the ease or speed with which one can obtain the loan;
- Encouraging the consolidation of a number of already-existing loans;
- Giving the impression that the rates proposed are the only ones that can be applied;
- Referring to "free credit" is prohibited, but the advertisement *can* announce an APR of 0%; and
- Canvassing at home and in the workplace is also prohibited. (Similarly, telephoning to propose a visit is regarded as canvassing.)

The rules in effect regarding advertising are relatively good, but are not being respected by providers nor enforced by the regulator. Violations are especially numerous on the internet. For example, a study was conducted by the Belgian Ministry of Economy in 2012 at the request of the European Commission. The results were disastrous: only four web sites out of 93 complied with the Belgian legislation – a mere 4.3% of online financial providers.

The most frequent abuses online were:

- No mention of the lending rate or of the total amount to be reimbursed;
- Referencing the difficult financial situation of potential customers as a means to persuade; eg, "Even if you are turned down elsewhere" and "Decision within an hour";
- Omission of obligatory information concerning the company; and
- Unclear information on the credit proposed, eg, confusion with mortgage loans.

In order to address these shortcomings, Test Achats recommends:

- All forms of canvassing should be prohibited. It is the consumer who must go out and seek the credit, not the contrary. The very principle of responsible credit requires this; and

- Frequent monitoring by the authority (FPS Economy) responsible for supervising the application of the law.

Obligation to provide information and advice

Legislation

Before granting credit, the lender must:

- Consult the Central Office for Credits to Private Individuals (CCP) maintained by the National Bank of Belgium. The CCP records all consumer credit and mortgage credit contracts currently active in Belgium. Contracts which are in default appear in a 'negative' file.

- Assess the appropriateness of the credit: the lender must refuse to issue credit if it believes that the consumer will not be capable of repaying. Consulting the CCP isn't sufficient, but the law doesn't specify the information that must be collected from the candidate borrower (income, charges, debts, etc.).

- Propose the type of contract and the amount that are best suited to the consumer´s financial situation and for the intended purpose of the credit.

- Give all useful information concerning the credit contract proposed in a SECCI (Standard European Consumer Credit Information) form.

Test Achats investigations illustrated that the above referenced obligations are not being respected. The lenders (particularly the brokers and sellers) gather only minimal information on the financial situation of the candidate borrowers. They generally make inquiries about the loan applicant's income and their housing situation (eg, owner, mortgage loan in progress, renting, etc.) but they pose few or no questions about the consumer's additional obligations (eg, energy, alimony payments, other debts, etc.) which is essential information for assessing the ability to repay.

Lenders do tend to consult the CCP, but do not appear to consider the data in the positive file. An example from an investigation conducted in stores in 2012 showed that consumers with an income of 2,500 EUR who also had six separate consumer credit accounts open were still able to obtain a new loan of 1,250 EUR without difficulty.

Providers do not consider the intended purpose of the credit when determining the amount of credit offered. For example, Test Achats' secret shoppers mentioned that they wanted to purchase a washing machine valued at 600 EUR, and were offered credit of 1,250 to 3,000 EUR.

In addition, the law says that the SECCI must be submitted "in good time and prior to the conclusion of the contract". In fact, it is always submitted *at the same time* as the contract to be signed, and thus fails to fulfil either its purpose of providing information, or that of facilitating comparison between several different offers.

In order to address these serious abuses Test Achats is proposing that:

- Lenders should be required to complete a questionnaire prior to granting a credit. Their obligation to provide information should also be defined;
- The checks performed by the financial services providers are more rigorous; and
- That the SECCI be submitted in a timely manner such that this document can fulfil its pre-contractual information purpose.

When cases are submitted to the courts (which happens all too rarely), the judges tend to be tough on lenders who do not actively gather information on the consumer´s ability to reimburse. They generally require a reduction of the debt to include only the principle (without interest or penalties accrued) which is one of the sanctions provided for by the law.

Examples include the following sentences:

- Chatelet 01/03/2012 "did not properly assess the borrower´s situation";
- Grâce-Hollogne 17/01/2012 "no objective analysis was performed regarding the precise financial situation of the consumers"; and
- Verviers 19/03/2012 "does not furnish proof that it sought to obtain the required information."

The right of withdrawal

Legislation

The law gives the consumer a grace period of 14 calendar days dating from the conclusion of the contract, during which time he can renounce the credit. A problem exists, however, when the credit is for the purchase of a good (eg, a car), because renouncing the credit does *not* cancel the underlying sale contract for the goods at issue.

Cost

Legislation

- All of the costs relating to the credit must be included in the APR (file costs, management costs, credit card costs, obligatory insurance costs, commissions for the intermediaries, etc.);
- This enables the consumer to easily compare the offers, and to understand the difference between the total amount to be reimbursed, and the amount lent;

- To prevent excessive rates in the credit market, the Belgian law establishes maximum APR that cannot be exceeded by the lenders. This can be revised upward or downward twice a year in accordance with reference indexes;
- This legislation makes the market properly transparent;
- The setting of maximum APR protects consumers against usurious rates;
- There remains a problem with regard to opening credit lines (opening a credit line means making funding available to the consumer and the related APR is only applied when an amount is drawn on the line of credit; thus the consumer cannot know the rate in advance).

Test Achats proposes, therefore, that the credit establishments be obliged to communicate in retrospect (eg, each year) the APR actually paid for opening lines of credit.

Term

Legislation

To avoid excessively long periods of indebtedness, the law limits the maximum term of reimbursement as a function of the borrowed amount. However, the opening of lines of credit for an unlimited term was not covered by legislation until 1 January 2013 when the law mandated that these be periodically reset to zero.

The opening of a line of credit is the most frequent cause of consumer over-indebtedness in Belgium. Many commercial channels propose 'revolving credit', whereby reimbursed money can again be withdrawn without a new application. However, this ease of access to credit means that the debt could very well become a permanent burden to the consumer. The idea of 'zeroing' is thus a good one. Test Achats supports the idea of putting finite limits on the availability of revolving credit contracts.

Non-payment

Legislation

The law limits the indemnities that can be claimed by the lender if the borrower defaults on payment.

This 2010 modification was a clear improvement because, prior to this legislative change, providers were requiring excessive penalties which had little or no relation to the damages incurred by default.

Chapter 4

The case of Fiji: Irresponsible lending practices in consumer credit markets

Premila Kumar, Chief Executive Officer, Consumer Council of Fiji

This chapter looks at three aspects of lending in Fiji where Consumer Council of Fiji (CCF) recommends policy and regulatory reforms. First, reform is needed to deal with unsuitable credit products in the marketplace and inadequate assessments of borrower's ability to repay by providers. Second, regulatory intervention needs to occur when improper financial advice is provided by financial institutions with regard to their own loan products. Third, regulatory attention is needed to rein in unregulated credit bureaus such as Fiji Data Bureau (FDB), which collects and exchanges the credit and financial information of consumers to credit providers.

Why these are problem areas

Unsuitable credit products and unregulated credit bureaus have become serious impediments to consumers' access to quality credit in Fiji. The persistence of injustice in this sector has resulted in Fijian consumers losing their life's savings, going bankrupt or remaining heavily indebted for decades. In recent years, the CCF's advocacy in the financial sector has unearthed cases in which consumers' rights have been compromised in these and other areas of financial services. The key problems are weak and inadequate financial consumer protection laws, poor enforcement and an expensive redress system that in effect protects irresponsible lenders, because consumers cannot afford justice.

The following are significant gaps in the policies and practices guiding the credit market:

Consumer Credit Act 1999 and Consumer Credit (Amendment) Act 2006 and Regulations 2009

The Consumer Credit Act[11] requires inspectors appointed according to the National and Trade Measurement Decree 1989, including a director and an assistant director, to enforce the Consumer Credit Act and Regulations. It is significant to note that these inspectors are technical staff who are not experts in financial issues, but who are (oddly) specialised in technical meteorology and standards. Thus, these inspectors are incapable of enforcing the Act, and this is one reason for its ineffectiveness and poor enforcement.

[11] Consumer Council of Fiji Report (2012): Review Report on existing Consumer Protection Laws in Fiji, Suva.

In addition, the Act[12] lacks penalties for breach and/or compensation for consumers in the event of abuses. So, for any breaches under the Act, a grieving party has to institute legal proceedings before a court of law which is expensive, cumbersome and time consuming. And, even if the consumer wins on the contractual issue, he or she loses that additional sum in legal fees.

Mortgagee sale

There are no consumer protection provisions regarding transparency of terms of sale, or disclosures to the mortgagee with regard to tenders, price, result and proceeds of sale, etc.

In Fiji, financial institutions initiate the sale of the mortgagee's property without input from the consumer. Banks have a panel of lawyers who are appointed by the bank to oversee the sale. The settlement also takes much longer, because the lawyers protect the interests of the financial institutions to remain on their panel of solicitors. A longer period means more legal fees for the lawyers and more interest earnings for the banks.

The current law also expects the borrower to go to court to seek relief (if denied by the banks) for changes to credit contracts under hardship, to postpone a mortgagee sale or re-open any unjust transaction. If a consumer is facing difficulty meeting his/her monthly payments, then it is unlikely that he or she can afford to take the case to court for relief of the hardship. Further, there is no obligation for the banks to seek a court order before the house is auctioned or prior to a mortgagee sale whereby the court could make an independent assessment of value and merit of the sale.

Hire purchase

Hire purchase (HP) companies[13] have been profiteering for decades through the illegal calculation and application of interest rates. Instead of calculating interest on a daily reducing balance, HP companies calculate interest for the entire duration of the credit contract on the basis of the full sum of credit taken (flat with compound interest applied). This overcharging ranges from 87 to 95%, resulting in an amount almost twice the value of the product issued. This is an illegal practice that generates an income of 13.3m FJD/annum. The Act states that interest charged should be on the actual outstanding credit, calculated on a daily basis. Any deviation from this would be contrary to law. Hence, millions of consumer dollars are being siphoned off by HP dealers through adopting a method of calculation which is illegal. Poor enforcement of the Consumer Credit Act has given further boost to this industry.

[12] Karan Ram (2012); Review of Consumer Credit Act and Regulations - From Consumers' Perspective. Suva.

[13] Chand Ganesh (2012): The Hire Purchase Industry in Fiji, Suva

The repossession market is another revenue stream for HP companies, which earn an estimated income of 7m FJD/annum targeting lower income groups the most. The resale of the repossessed items typically takes place at the HP company's stores/warehouse at a very low price. No evidence or disclosure on the resale is provided to consumers to verify the facts. Unfortunately, there are no laws or regulations covering resale of repossessed items. There is also no requirement that the dealer must sell the item at fair market value, or even provide notice to the consumer regarding any part of the resale process. Reforms in this area are overdue to protect low income consumers, and to stop HPs from profiting at the expense of consumers.

The CCF's 2010 report *Banking Services in Fiji: from Consumers Perspective*[14] found amongst other issues that the banking sector is "highly uncompetitive," and that consumers faced many barriers to access credit such as very high interest rates, fees and charges and lack of consumer protection by the regulator, the Reserve Bank of Fiji (RBF).

RBF has been preoccupied with the prudential regulation of licensed financial institutions, although industry stability and profitability have been stable for decades. RBF's focus on the financial well-being of the financial sector without equal consideration of the significant costs that the unfair business practices have on vulnerable consumers is extremely short-sighted. RBF currently does not have adequate powers to intervene when there is bad market conduct. In fact, Fijian consumers have not seen RBF take any action against the financial institutions.

RBF did establish a Complaints Handling Unit. However, this unit has no legal powers to fine financial institutions engaged in unfair trade practices, or penalise institutions that are negligent.

RBF and other regulators have done far too little to address issues faced by consumers in the lending market. Also, there are financial institutions which are not licensed by RBF and which are operating without any supervision and thus putting consumers at risk.

The CCF is lobbying the government to set up a financial services consumer protection commission independent from the RBF. Not surprisingly, the banks have lobbied strongly against the establishment of such a commission as proposed by the CCF.

Lending practices in Fiji

Financial institutions enjoy a liberalised credit sector. RBF does not specifically regulate lending practices in terms of how banks provide loans – it only requires banks to provide disclosures on items like interest payable, term of loans, fees and charges, etc. It does not set interest rates, and has only recently removed a few fees and charges after CCF's strong

[14] Dulare Chandra (2010) *Banking Services in Fiji: From Consumers' Perspective,* Consumer Council of Fiji, Suva, http://www.consumersfiji.org/upload/Reports/CCF%20Bank%20Services%20Rpt.pdf

advocacy for these changes. The Association of Banks in Fiji (ABIF)[15] has a 'Code of Practice' where Part 8.0 (Provision of Credit) generally covers what banks should do when providing credit to consumers. The Code however does not proscribe specific lending requirements, nor does it address the issue of 'irresponsible lending'.

The inadequate regulatory protection from the RBF and the ABIF's inability to address irresponsible lending (in its own code of practice) means consumers are at risk. In fact, credit institutions are given *carte blanche* to engage in various practices which harm consumers.

The following are CCF's recommendations for regulatory intervention to better protect financial consumers:

Unsuitable credit products and assessment of affordability

Disclosure of information

Currently, information on financial products and services is available in the form of marketing materials which provide minimum disclosure of critical information. These materials do not fully disclose the actual costs, risks, and documentary requirements that bank customers require. At present, while individuals are taking more responsibility for their financial security, financial products offered to consumers are more complex and marketed to consumers using information which is more promotional, versus informational. This makes financial products harder to understand and impossible to compare; it also increases the risk of buying an inappropriate product because advertising appeals to emotions, rather than communicating the requisite product details necessary to make a sound, rational choice.

For example, information on ANZ's personal loan and other loans show **"**features at a glance" which include "total flexibility", "no restriction on loan amount" and other enticing phrases.

Upon further clarification with an ANZ customer care representative, it was disclosed that to qualify for a personal loan, the consumer needs to be with their employer for more than two years, and the loan amount is deducted from the customer's weekly/fortnightly salary, which must be sufficient to make repayments.

Information that is offered to consumers is often incomprehensible, insufficient and presented in a variety of forms, making it difficult for consumers to comparison shop. Financial services firms should ensure that their customers understand the terms and conditions and other important details such as number of instalments and amount to be repaid when they contract for financial products and services such as mortgages, consumer loans, etc.

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[15] http://www.abif.com.fj/home/

Assessment of affordability

Lenders should assess the financial capacity of consumers and provide products that are suitable. It has been noted that 'teaser' mortgage loan promotional rates are used to lure consumers. Attractive fixed interest rates are provided for the first year, which then change to a variable interest rate after a certain period of time. The CCF analysed mortgage loans from five institutions to find that the first year interest rate is attractive — ranging from 7.45 to 7.99%. After the first year, the rate increases substantially, puzzling consumers who have not been told the implications of a variable rate on their ability to make future payments. Effectively, financial institutions have nothing to lose because they require consumers to provide collateral and a guarantor prior to loan approval and disbursement. At the end, it is the consumer who bears the risk.

The CCF has also noticed that banks and other financial institutions are offering more than just home loans to customers who are a high credit risk. We have examined cases of irresponsible lending to consumers who have defaulted on their loan repayments after receiving a loan which was well beyond their ability to repay. The following is a case where a leading home loan provider, Home Finance Company Ltd (HFC), irresponsibly provided extra credit to a customer whose underlying loan was for housing, after which he was provided additional credit with no commensurate increase in his ability to repay.

> Mr T is a senior civil servant and the sole breadwinner for his family. He first borrowed 156,000 FJD from HFC for a home loan in 2002 and now the total borrowed amount stands at 333,464 FJD and to date he has paid a total of 318,741 FJD. As of May 2012, he still owed 325,604 FJD. The CCF discovered that the complainant was offered repayment holidays in 2003 and 2004 because he was not able to make repayments. Despite this, he was given an additional loan of 81,000 FJD to start a business. HFC also loaned him 10,000 FJD for the family to travel to Australia. In 2005, he defaulted on his account, and yet was given another loan of 57,942 FJD. It was irresponsible to continue to give a business loan, a travel loan and another loan for an undisclosed purpose when the consumer was finding it difficult to meet mortgage payment obligations to the same bank.
>
> By 2008, the consumer had a total debt obligation of 374,784 FJD at the age of 54 (retirement age in Fiji is 55) where the value of his property was only 340,000 FJD. How can a bank continue to approve loans which are more than the value of the collateral? Certainly, the consumer engaged in irresponsible borrowing, but he was enabled by an irresponsible lender.

The bank staff were fully aware of the customer's payment history, and yet continued to give him loans. The CCF concludes that perhaps the bank's sales incentives for employees need to be re-evaluated.

Improper financial advice and lack of consumer affordability checks

Consumers rely on the advice of a familiar bank employee or financial advisors provided by their financial services provider, because they perceive them to be trustworthy and experts in their profession. However, there is growing evidence that consumers often do not get suitable advice, which results in the purchase of inappropriate products.

Unfortunately, the reliability of advice is suspect, because the advisors are reliant on the financial institution for employment or commissions. This presents a conflict of interest to the detriment of consumers. The CCF is aware that sales incentives for bank staff are provided in the form of bonuses, promotions and other perks tied to the volume of sales to consumers. This behaviour is also evident in the insurance industry where insurance salespeople are given awards, bonuses and prizes for exceeding the sale figures acquired during the year.

The CCF has also encountered cases where a customer has lost more than one property due to outstanding arrears that were much lower than the market value of the mortgaged property.

> A complainant, Mr H, had a principal debt of 400,000 FJD with a major Australian bank for three properties; one of which was his residential property. Due to a business downturn, Mr H was unable to repay his loans and was 59,763 FJD in arrears. His three properties were valued at 285,000 FJD; 240,000 FJD; and 67,000 FJD by the bank's recommended valuer. It sought to recover its arrears through a mortgagee sale. The bank received tenders for 140,000 FJD, 120,000 FJD (made by the bank officer of another bank) and 43,000 FJD (a law firm who initially acted for Mr H).
>
> During CCF's investigation, the mortgage issuing bank admitted that Mr H was banking with another bank, and after facing financial difficulty he obtained refinancing of 369,000 FJD followed by a top up of 65,000 FJD. The bank admitted that the facility very quickly went into arrears. The bank's credit review clearly showed that Mr H had minimal cash flow to support his property assets which were over valued. The bank also admitted that the original loan should not have been granted, and this was one of the several accounts where the loans officer abused the approval authority given to him. The loan officer was dismissed for breaching the bank's lending guidelines. In fact, the loan officer resigned and the bank did not take any legal action against this staff member. The bank also accepted that Mr H was probably given a larger advance than would normally be permitted. It clearly indicates that the loan officer did not take all reasonable steps to verify the accuracy of information provided in support of the loan application.
>
> Further, Mr H was not given reasonable time to conduct a private sale. Instead, the bank used its panel of lawyers (paid for by Mr H) to conduct a mortgagee sale

which lacked transparency. They also should have conducted only one sale; utilising that sum to service the arrears. Mr H was left powerless. As he was already in a very bad financial situation, he could not afford to hire a lawyer to defend his legal rights.

This case underscores the need to put in place safety nets and protective measures to protect consumers from unfair mortgagee sales and illegitimate processes employed by banks. Further, consumers should be compensated for erroneous and harmful advice given by bank employees or by financial advisors.

HP companies must seriously consider conducting financial background checks on consumers before engaging in irresponsible lending. The CCF is concerned as low- and middle-income earners who can barely afford multiple HP accounts continue to gain approval from HP companies.

All HP companies require consumers to produce evidence of income when a new account is established. However this seems to be just for show, as no further verification is carried out on the same consumer, should he/she wish to purchase more items on HP.

While CCF agrees that consumers need to be responsible and only engage in HPs within their budget; it has been found that such consumers end up with multiple HP accounts, bank loans and other debts and are unable to keep up with repayments consistently.

The CCF continues to find evidence where credit institutions do not exercise due diligence in checking whether their customers can afford the purchase. An example follows:

Mr K is the sole breadwinner in his family and he is earning 156 FJD/week (624 FJD/month). He has three HP accounts, two unsecured bank loans, a credit account and a loan from a moneylender. Mr K had two HP accounts[16] worth a total of 1,357 FJD with Courts and 780 FJD with MH Carpenters; he had a MoneyLink credit card with 300 FJD limit with MH Carpenters; a 300 FJD loan (20% interest) from Handy Finance, a moneylender; and two unsecured personal loans amounting to 880 FJD from ANZ bank.

The HP companies and the bank appeared to have broken their own lending policies. Mr K was overwhelmed by the accumulating arrears that he was unable to pay and came to the CCF seeking advice. For his HP and bank loans (excluding payments to the moneylender) he was liable to pay a total of 362 FJD per month and he was left with only 262 FJD cash/month for his living expenses. He could not pay the MoneyLink credit card which was in arrears of 370 FJD when he sought assistance from CCF. Mr K

[16] One of the companies at issue informed the CCF in writing that, “HP is risky lending with approvals given in minutes for our customer’s convenience without charging any approval fee. We also deal with a substantial number of very low to middle income earners who have very sketchy and/or no proof of income details or verification records at all.”

constantly borrowed money from his workmates because he was unable to live on 66 FJD/week.

Most of the HP companies do not use 60/40 debt ratio as a qualifying criteria. Most credit and financial institutions have been guilty of irresponsible lending by not conducting credit assessment of their customers.

Lenders should ensure that information about options and assistance in the event of financial hardship is accessible and available to all borrowers. Many of the standard letters sent to borrowers when they default could be improved by providing clearer information. Additionally, this information should be provided at the outset of the borrower/lender relationship so that the consumer is well aware of the bank's procedures and all penalties in the event of a default. Borrowers would also benefit from being provided with information about their rights to request relief on the grounds of financial hardship, and the options available to them to dispute a decision.

Unregulated credit bureaus: Fiji Data Bureau

The existence of the Fiji Data Bureau[17] (FDB), a provider of information on the credit history of consumers, has come under the spotlight due to the absence of privacy laws or regulations governing the exchange of personal financial information by third parties. FDB was established under the Companies Act by Fiji's leading financial and credit institutions in 2001 to allow its paying members to share personal financial information of their clients and potential customers. FDB has a Code of Conduct to avoid breach of confidential information. FDB has become an integral part of lending practices in Fiji, and statements of declaration of authorisation by consumers have become standard in loan or HP application forms (see example below). As part of the loan processing, consumers are obliged to sign such declarations without understanding the consequences of allowing their private financial history to be openly viewed by unregulated third parties. Key information is included in fine print amongst the various substantive terms and conditions of the loan/credit documents which consumers sign (see example on page 33).

FDB's system is fraught with errors that result in embarrassment, inconvenience and financial costs to consumers. FDB is not accountable to any regulatory agency regarding its business of trade in personal credit information. Further, FDB takes no responsibility for the accuracy of the credit information uploaded or exchanged by its members. Instead it requires members to "...ensure that the debts loaded are accurate..." (Clause 10 – Code of Conduct).

[17] http://www.databureau.com.fj

An example of a customer declaration of authority for access to and exchange of their financial/credit information to third parties

STATUTORY INFORMATION

……………………………………………………………………

1. I/We irrevocably authorize Courts (Fiji) Ltd to obtain a report about my/our commercial activities or commercial credit worthiness from Data Bureau Limited and/or any other firm or company which provides information about a person's commercial credit worthiness for the purpose of assessing my/our credit application.

2. I/We also irrevocably authorize Courts (Fiji) Ltd to exchange information about my/our credit arrangements including information about my/our credit worthiness, credit history, credit standing or credit capacity with other credit providers. This information may be used to assess application for credit and or my/our credit worthiness, to assist me/us to avoid default and notify other credit providers of my/our default.

3. I/We also irrevocably authorize Courts (Fiji) Ltd to make enquiries about the information included on my/our credit application from any other sources.

4. I/We irrevocably authorize Courts (Fiji) Ltd to retain an electronic copy of the document, which shall be enforceable in any proceeding against me/us and that the original has been provided.

Customer Signature/s 1) ………………………………… Customer Signature/s 2) …………………………………..

It requires that: debts are over 90 days; are not in dispute with the customer; and that there is no financial arrangement in place. The fact that consumers have been wrongly listed is already evidence that FDB's requirements from its members are not being strictly followed, or that the bureau itself does not have a system in place to properly check data, and audit the accuracy of information supplied by the members. The case below highlights the injustices consumers face as a result.

> Mrs S purchased a washing machine from a HP company worth 729 FJD. The washing machine was damaged during a flood and was not insured. Thus, the HP company collected the item and provided a replacement washing machine valued at 599 FJD. According to Mrs S, she owed no money to the credit provider. After a year, Mrs S decided to purchase another item under HP. She was told that her name was listed with the Data Bureau for arrears of 36.37 FJD with the previous credit provider. Mrs S was unaware of the amount owed to the credit provider. She had no knowledge that her name was listed with the Data Bureau as a defaulter. She sought assistance from the CCF to get her name off the Data Bureau database.

The current credit bureau system is unfair and denies the majority of consumers in Fiji access to credit or goods/services particularly during difficult economic conditions. Privacy and credit reporting legislation is critical and should carefully balance the ability of creditors to share information with the individual's right of privacy and consent/understanding. Consumers should, at a minimum, be given access to their own credit record on an annual basis at no charge to determine the veracity of the information aggregated about themselves.

CCF's agenda on reform in the financial services

From 2010 to date, the CCF has engaged with regulators and policymakers to highlight the flaws in the policies and practices that exist in the financial sector in a bid to bring about reform.

Through education and awareness programs, the CCF will continue to raise awareness about the lack of protection of consumers in the financial sector. It will use various forums such as workshops, radio call in shows, TV programmes, eg, *Dollars and Sense*, and feature articles in the business column of *Fiji Times* to highlight problems faced by consumers in the credit market.

The CCF is working closely with the Minister responsible for consumer affairs to set up a consumer tribunal to provide simple, speedy, inexpensive redress to consumers of financial services as well as other services. Currently, the redress sought by aggrieved consumers is only available through civil courts, which are often costly, complex and time consuming. Inordinate delays coupled with high costs discourage consumers from taking their grievances to the courts. The CCF is awaiting Cabinet approval on the establishment of the consumer tribunal, which will be informal in nature allowing consumers to be able to seek redress by filing their own claims.

The CCF will continue lobbying for reforms in the Consumer Credit Act 1999 as amended in 2006 and Regulations 2009. The idea is to shift the enforcement of the legislation to a competent institution such as the Independent Financial Institution and/or ombudsman rather than the Ministry of Industry and Trade.

Policymakers now recognise that easy access to personal financial information of consumers, without any regulatory oversight, is a risk to consumers. They realise that consumers' financial details can be exploited by the credit providers who are members of the Data Bureau regardless of whether the person is their customer or not. The CCF will continue with its advocacy work to put in place a legislation to address the issue of privacy of personal credit records of consumers.

Conclusion

The CCF believes that the aforementioned three areas need urgent policy and regulatory reforms to ensure that there is responsible lending in the financial services or consumer credit sector. Many consumers want to borrow money and have a genuine desire to service their debts. However, there are also consumers who are easily swayed by the sales tactics of banks and bank staff who often attempt to sell as many loans as they can, motivated by promises of bonuses, perks and market share. Irresponsible borrowing can be addressed through transparency in dealings between creditors and borrowers and where financial institutions undertake due diligence to ensure consumers are in a position to repay their loans.

Consumers should not be targeted with credit products that are clearly unsuitable for them. Policies and regulations need to address bankers' high pressure selling, and aggressive conduct which is deceitful and unfair. Debt collection agencies such as Fiji Data Bureau are now part of standard lending practices in most countries; however, for Fiji the lack of privacy laws and relevant regulations governing the sharing and exchange of consumers' financial information exposes consumers to exploitation by unscrupulous lenders.

Chapter 5

A constitutional right to debt relief: The Greek approach to alleviating over-indebtedness

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The law on over-indebtedness

In September 2010, Law 3869/2010 was enacted, introducing the right to personal bankruptcy in order to address the problem of over-indebtedness, which has become a massive social, political and economic phenomenon in Greece. The implementation of this law was also an attempt to harmonise legislation with Article 5, paragraph 1 of the Greek Constitution[18], which protects the participation of citizens in social and economic life; and guarantees a right to the development of a personal life as well. The legislation was also viewed as a clean slate for many people, who found themselves chronically over-indebted because of the totality of their economic circumstances, such as: unemployment or under employment; an increase in the cost of living since joining the Euro; high interest rates, especially in the field of consumer credit; predatory practices on behalf of the banks overselling credit; poor household budgeting; and an overall absence of financial counseling and adequate information. All have contributed to an increased state of consumer over-indebtedness and disastrous related consequences.[19]

According to the new law, over-indebted individuals, who are not part of a company structure and who do not have business loans, now have the possibility to restructure debts; reducing both the interest and total amount owed. The prerequisite is that the individual's inability to repay is considered a permanent condition. Consequently, the consumer who is over-indebted through no fault of his own now has the chance to have a new economic start in life, released from the obligation to repay a significant amount of his debt, while retaining the right to his primary residence.[20]

The main difference between the bankruptcy procedure for companies and that of consumers relates primarily to the purpose. With corporate bankruptcies, the primary objective is the creditors' satisfaction, often resulting in the winding up of the bankrupt business. By contrast, the objective of a personal bankruptcy is the reintegration of the over-

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[18] http://www.hellenicparliament.gr/UserFiles/f3c70a23-7696-49db-9148-f24dce6a27c8/001-156%20aggliko.pdf

[19] Additionally, according to Bank of Greece, in late March 2013 nonperforming loans (NPLs) in Greece climbed further to 27.8% of total loans in March 2013 compared to 24.5% at end-2012, 21.4% in June 2012 and 16.0% in December 2011. NPLs in mortgages climbed to 22.9% (from 21.4%) and in consumer loans to 42.4% (from 38.8%).

[20] In order to retain the right to the primary residence, the over-indebted consumer must pay 80% of the objective value of the house over a period of 20-35 years (it depends on the duration of the loan contract signed). If the restructuring is honored as agreed, the debt is forgiven.

indebted citizen into the economic and social life of the community with a clean financial slate. As a result, the full satisfaction of the creditor is sacrificed in favour of a new economic start for the consumer, who is set free from the insurmountable economic burden, provided he has been unable to repay for at least four years. In practice, filing for bankruptcy protection can protect an individual's primary residence and enable him to restructure his loans over a 20-year period in order to repay his creditors.[21] In this manner, the individual can reserve a decent minimum amount for the cost of living. In the event that his/her economic situation changes in the period after the court judgment, it is possible to file a new petition to the court for an adjustment of the amount to be paid. The criteria for the determination of the amount are basically the same – a decent minimum amount for the cost of living must be reserved for the debtor. However, there are no standards that define the "decent minimum amount for the cost of living", and thus the estimation of the installment is based on the magistrate's discretion in each case.

The implementation of this law and its impact have been significant. From January 2011 to December 2012, there were 34,931 bankruptcy applications submitted to the courts, specifically to county courts. Seventy percent of the filings included a request for protection of the primary residence. And, during the first half of 2013, the number of applications for bankruptcy almost doubled; a fact which is highly indicative of the economic status of Greek households.

This alarming problem regarding the poor financial health of Greek households led our organisation, NEW INKA, to undertake two related projects to provide some assistance to consumers. The first project addressed over-indebtedness prevention via financial education, and the second involved pro bono legal assistance to over-indebted consumers.

Financial education for indebted consumers

With regard to the first initiative, the objective is to educate consumers so that they are better able to make informed choices in the financial services market. The need to promote financial literacy is high in Greece, and there are few policies in place to promote education on financial issues or to prevent over-indebtedness. Our target audience for the financial literacy project was consumers who are particularly vulnerable, including the disabled, the youth population, the long-term unemployed, immigrants and particularly low-income consumers who have difficulty accessing information and who are often victims of sharp practices. Consequently, NEW INKA's objective is the empowerment of vulnerable groups concerning financial matters, and especially improving their knowledge with regards to the purchase of financial products and services, and the avoidance of their financial exclusion. The project also focused on advisory services to help consumers evaluate options, and understand the implications of choices and their economic consequences.

[21] Unfortunately, however, there is no state provision for pro bono legal aid and consequently the filing for bankruptcy protection burdens the over-indebted consumer.

The above mentioned project was launched as a pilot and because of resource constraints assisted only 90 consumers belonging to the above mentioned vulnerable groups. One of the conclusions drawn upon completion of this project was that the standard of living in Greece is deteriorating at a rapid and constant pace. As a result, a significant portion of Greek society finds itself near or below the poverty line as the volume of over-indebted households grows, and family budgets are constrained due to income reductions and unemployment.

Out of the 90 persons who participated in the project 52% were male and 48% female, allowing us to conclude that over-indebtedness impacts the sexes almost equally. However, according to the European Commission, on average, women in Greece in 2011 earned around 22% less per hour than men. The impact of this gender pay gap means that women earn less over their lifetime, which results in lower pensions and a risk of poverty in old age. Additionally, New INKA noted a distinct correlation between the level of education and financial literacy. In addition, only 15.56% of the total participants requiring assistance had any university degree. Specifically, 10.64% of them were men and 20.39% of them were women.

The counseling procedure also highlighted the dire need for a permanent source of financial information and advice for consumers; both as a preventive measure and as a means of coping with the results of household over-indebtedness as a result of unemployment, salary and pension cuts, and the overall shrinkage of social and healthcare services by the State. This has led to a large portion of the population falling into poverty, irreparably damaging the fabric of society.

Provision of pro bono legal assistance

NEW INKA has also undertaken a second project to provide pro bono legal assistance to over-indebted consumers, because the cost of justice is substantial and not feasible for people already in economic distress. The project was implemented in collaboration with a consumer association called E.K.PI.ZO and involved assisting over-indebted consumers to submit bankruptcy applications to the county court. Again, due to the limited budget and the pilot nature of the project, there were only 89 persons selected from 500 applicants to participate.

The selection criteria were economic as well as social and again, priority was given to vulnerable social groups. In fact, 62.96% of the participants were unemployed, 14.61% were retired with a disability, and the remainder were civil servants and persons working irregularly. The majority of the participants earned approximately 500 EUR/month. Moreover, 55.06% of the participants have a family member with a serious health problem, whereas 12.36% of the beneficiaries receive their food supply from charitable organisations. Thus, it is more than obvious that there is a need for the State to cover the costs of the bankruptcy filing for the already indigent. Unfortunately, the status quo at present is that only those who do not need to file for bankruptcy in Greece can afford to do so.

Chapter 6

Crisis of lending to the poor in India: Challenges and the possible way forward

George Cheriyan, Director, CUTS International, and Head, CUTS Centre for Consumer Action, Research & Training

One in three of the world's poorest live in India, the world's second-fastest growing economy, according to a new study (The World Bank, 2013). Though several poverty-alleviation programmes have been initiated by the central and state governments, reports show that access to credit with low interest and on accessible terms in rural areas is still a matter of serious concern. This is due to the fact that poorer segments of the population have no tangible assets to offer as security, and hence cannot take advantage of the liberalised system of bank credit. Thus, several measures have been taken by the government to address this specific issue in the recent past, with the intent of extending financial assistance to the rural areas and the weaker sections of society.

The poor need financial services to build assets, to protect against risk and for basic household needs. For decades, the bulk of the poor were dependent on landlords and local money lenders for their financial requirements, eg, religious celebrations, medical costs, school fees, etc. The money lenders and landlords have long had a vice-like grip on the poor and their meagre assets, eg, small plots of land, gold ornaments, or livestock which are often mortgaged with a landlord or money lender. Over time, there has been a marked improvement in the rural economic situation, yet the smaller credit requirements of the low income groups remain largely unmet.

Financial services for the poor have long been a public policy goal for India. Microfinance started in India around 1980. The movement gathered momentum with the establishment of the National Bank for Agriculture and Rural Development (NABARD) in 1982 to provide financial and development policy support to microfinance initiatives through the SHG-Bank Linkage Programme in 1992.

Reports show, however, that about 40% of the Indian population still lack access to any kind of formal financial services (Reserve Bank of India (RBI), 2012). In rural areas, only 39% of the population has a bank account compared to 59% in urban areas. The un-banked population is even higher in the poorer regions of India such as the northeastern and eastern regions. Non-banking channels are the only available source of credit for large segments of the rural population, as well as the urban poor. In India, *financial inclusion* first featured as a policy goal in 2005, when RBI directed banks to make available a basic 'no-frills' bank account.

Emergence of microfinance institutions and their role in financial inclusion

The priority sector is a government of India defined term for those sectors of the economy which may not otherwise access credit in the absence of special considerations or incentives. Typically, the aim is to offer small-value loans to farmers for agriculture and related farm inputs and tools; micro and small loans to the poor for small businesses and for housing; and educational loans for students.

Priority sector lending is a government initiative which requires banks to allocate a percentage of their portfolios to investment in specified sectors at a reduced interest rate. As a result of Government of India (GoI) priority sector lending policies, and with financial inclusion emerging as a major policy objective in the country, microfinance has occupied centre stage as a promising conduit for extending financial services to the unbanked.

Microfinance is not just about giving micro credit to the poor, but rather it can also be an economic development tool to assist the poor to work their way out of poverty. It covers a wide range of services like credit, savings, insurance, remittances and also non-financial services like skills training, financial counselling and support to operate one's own business in an efficient manner. The borrower receives all these services at his door step, and in most cases with a repayment schedule tailored to the borrower's capacity to repay and cash flow. Microfinance institutions (MFIs) were expected to supplement banks, and to tailor their financial and other services to the needs of the poor.

Channels of operation of MFIs

In India, microfinance operates primarily through two methods. One is the Self Help Group (SHG)-Bank Linkage Programme (SBLP) and the other is MFIs.

Under the SHG model, the members are usually women in villages who are encouraged to form groups of around 10-15. Members contribute their savings to the group periodically, and from these savings small loans are provided to the members. Subsequently, these SHGs are provided with bank loans, generally for income generation purposes. The group's members meet periodically when the new savings are deposited, recovery of past loans is affected from those members with outstanding loans, and then new loans are disbursed. This model has been quite successful in the past, and with time it is becoming more popular. It has also been the model supported by the GoI through NABARD. The SHGs are self-sustaining and once the group becomes stable, it starts working on its own with some support from NGOs.

Those institutions which have microfinance as their main function are known as MFIs. Provision of credit services to the poor and the very-poor, particularly in rural areas, is the purpose of MFIs. Organisations of different sizes and legal forms offer microfinance services. These institutions lend to groups applying the concept of joint and several liability. The group is composed of five to 10 individual members who come together for the purpose of obtaining loans; either individually or through the group lending structure, whereby each group member is a guarantor of the other members' loans. This joint and several liability acts as a substitute for physical assets as collateral, which the poor often lack.

Contributing towards alleviating poverty and empowering women: Case of Bandhan Financial Service

'Finance is a legitimate business, and one does not have to be a bank to do it.' As a microfinance lender, Bandhan Financial Services has proved itself with over a decade of experience serving the poor since its inception in 2001. Bandhan is one of the few large MFIs with more than 1bn in lending. Its low operational expenses come from the staff, as most of them are Bandhan's borrowers. Around 80 per cent of its total lending is rural. As of July 2013, Bandhan serves more than 4.7m poor people through its network of 1,816 branches spread across 19 states of the country with credit offered of more than 5.81bn. Bandhan is basically focused on the eastern and northeastern parts of the country.

One of the primary goals of Bandhan is to work with women who are socially disadvantaged and economically exploited. Bandhan works for their social upliftment and economic emancipation. Aspiring to achieve holistic development of the poor, Bandhan offers development activities in crucial fields of education, health, unemployment, capacity-building and livelihood. Additionally, it also has a programme exclusively for the extremely poor (generally believed to be overlooked by MFIs in favour of serving the income-generating poor). Primarily, Bandhan was set up to address the dual objective of poverty alleviation and women's empowerment. Recently, an IIM-Ahmedabad's impact evaluation study on this microfinance leader observed that the average annual net income of West Bengal households under Bandhan's business witnessed an increase of INR 13,231 from all sources, representing an increase of 13.81%. Unlike other MFIs, Bandhan was not affected by the multiple lending that caused the Andhra Pradesh crisis.

Microfinance, due to the unique challenges of serving the poor, comes with higher interest rates than charged by commercial banks which can vary widely from 10 to 30%/annum.

Additionally, there are two distinct types of MFIs: the Non-Governmental Organisation (NGO) and the Non-Banking Financial Company (NBFC). NGO-MFIs operate as non-profits and provide both microfinance and non-financial services. NBFC-MFIs are for-profit MFIs that have access to capital markets and qualify for priority-sector lending. Non-Banking Financial Companies (NBFCs), co-operative societies, societies and trusts, all such institutions operating in the microfinance sector constitute MFIs and together they account for about 42% of the microfinance sector in terms of credit portfolio. The MFI channel is dominated by NBFCs which cover more than 80% of the total credit portfolio through the MFI channel. Currently, only MFIs registered as NBFC-MFIs are designated as a priority sector. In 2011, the size of the microfinance sector was expected to grow to about 250bn INR.

SEWA Bank, Ahmedabad
Mahila SEWA Sahakari Bank is SEWA's largest and most important cooperative, and the first of its kind in India. The bank is owned by self-employed women through individual shareholdings, and its policies are formulated and ratified with their own elected board of women workers. The bank is professionally run by qualified managers, who are held accountable to the board. In 1974, SEWA Bank was established with 4,000 depositors. Today, it has about 300,000 women members and a working capital of 20bn INR. Sewa Bank charges an interest rate of 14.5 to 17%/annum.

The Case of Andhra Pradesh, India

Andhra Pradesh is the motherland of Indian microfinance, largely due to the early and extraordinary work of its state government. In the late 1980s, it built the SHG-Bank linkage programme with support from NABARD and World Bank loans. It invested heavily in client education and, along with the not-for-profit sector, built up a robust microfinance portfolio.

In 2010, a series of unprecedented suicides stemming from microfinance difficulties in Andhra Pradesh brought criticism from across the world. About 120 poor borrowers reportedly committed suicide because of financial duress, until action was taken by the government (Business Standard, 2012). This was a result of MFIs indulging in practices to gain inappropriate profits by charging high interest rates, coercive/aggressive money collection practices, and over lending to the destitute, thereby drifting away from the mission of helping the poor get out of poverty. The interest was in the 40% range (Economist, 2013). Based on the calculation of the amount deducted upfront from the loan by the MFIs, the effective rate of interest reported was between 35 and 65%/annum in some cases. The incident resulted in the Andhra Pradesh government passing the Andhra Pradesh Microfinance Institutions Act (Regulation of Money Lending) 2010, which includes a number of measures that greatly restricted MFI's operations. RBI also issued guidelines by the end of 2011, capping interest rates at 10 to 12% points above their own borrowing costs, limiting the interest rate in the rage of 23-27%/annum.

Stringent regulation affecting the poor

The Andhra Pradesh ordinance has several stringent clauses. For example, it prohibits MFIs from recovering interest dues that are more than the principal loan amount. Also, MFIs will have to go through local bodies such as *panchayats* for loan recoveries from individual borrowers every month. Currently, a majority of MFIs collect repayments from clients every week. The ordinance also prevents a borrower from taking on more than two microcredit loans at any given point in time.

The impact of the ordinance on MFIs in Andhra Pradesh has been significant with the drastic drop in loan repayments in 2011, from 99% prior to the issuance of the ordinance, to less than 20% of the loan amount due, and even down to zero repayment rates in urban areas and as low as 2% in rural areas, where it had once been a healthy 100%. More than 70bn INR in micro-borrower loans were effectively in default, with recovery rates at only 10%. In fact, MFIs are still struggling to recover from this crisis which was in a sense aggravated by the law designed to reign in MFIs. As a result, MFIs operating in Andhra Pradesh have ceased issuing fresh loans due to the growing non-performing assets, and the limited scope of recovery. The direct effect has been to deny millions of India's poorest citizens' access to basic financial services. Studies show that the ban imposed by the Andhra Pradesh government, without much research and evidence, resulted in a largely negative impact on the micro-finance industry, without significantly benefiting poor consumers.

Following the Andhra Pradesh Microfinance Ordinance, the RBI (the financial sector regulator) established the Malegam Committee to make regulatory recommendations for the entire MFI sector. This committee's mandate is to address the primary customer complaints that led to the crisis, including coercive collection practices, usurious interest rates, and selling practices that resulted in over-indebtedness. The committee released their recommended regulations in January 2011, and it suggested regulating only the NBFC-MFIs.

The draft MFIs Bill (Development and Regulations) 2012 (MFIB), which was cleared by the Cabinet, and then introduced in the Indian Parliament (bill No. 62 of 2012), has included all MFIs under the jurisdiction of the RBI and requires all MFIs to register with RBI. In practice, the majority of NGO-MFIs are dependent on bank loans to carry out their microfinance activities, and so they are also expected to fulfil the priority sector norms. According to the draft bill, RBI is the sole regulator for all MFIs. The bill is pending in the Indian Parliament, awaiting passage.

However, many are concerned about the proposed centralised regulatory mechanism at the national level and RBI being the single regulator, due to the quantum of regulatory work already being carried out by RBI, as the banking regulator. Hence, the alternative proposal is for a decentralised, MFI ombudsman scheme, having a state-wide system with a two-tier mechanism at the state and at the district level. At the first tier, the district level, a senior designated officer of the lead bank of the district can act as ombudsman. At the second tier, there could be an ombudsman at the state level, which could also act as an appellate authority.

Challenges and the way forward

The poor continue to need access to credit on easy terms. At the same time, poor consumers need to be protected from high rates of interest and coercive practices. The government has to perform a sensitive balancing act. The draft MFIB is a watershed moment for the microfinance sector in India, which puts the industry under strict monitoring. The proposed MFIB gives sweeping powers to the RBI to regulate lending rates and margins, in addition to setting prudential norms. One needs to wait and see the impact of this law after enactment and implementation.

However, as the sector completes more than two decades of operations with a high growth trajectory, an enabling regulatory environment that protects the interest of all stakeholders, as well as promotes growth, is needed. Government should not delay further to save this sector and act on behalf of millions of the poor in India.

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Chapter 7

The Italian status quo: Little access to credit on expensive and opaque terms

Anna Vizzari, Economist, Altroconsumo

Responsible lending means providing credit to people and assuring that they have the ability to repay the instalments on time. It also implies explaining to consumers the implications of failing to repay in a timely manner and the risks related to over-borrowing.

However, the real problem in Italy today is access to any credit at all. Even those consumers who have the financial prerequisites to get a mortgage, ie, a permanent job with a salary that is more than sufficient to allow them to make payments, in more than 25% of cases, find that they are not 'qualified for mortgages'. Thus, for consumers with part-time work, fixed-term or low incomes, accessing a mortgage is almost impossible.

This situation has led to lenders providing credit irresponsibly. Ethical banks and small regional microfinance projects like the MAGs and Microbo of Bologna are very small, serving perhaps hundreds of consumers, compared to the overall demand for funding.

Before 2008, mortgages were granted without difficulty for up to 80% of the appraised value of the home, whereas today, banks are only lending up to 60%. Similarly, before 2008 the ratio between monthly instalments and income was 33%, whereas today that figure is 20% (and less).

The spread for a variable rate mortgage of a 25-year period is on average 3.58% and it ranges from a minimum of 2.5% to a maximum of 6%, representing a financial product that is very expensive, and for many consumers not feasible. The situation is even worse for young people and for those employed with part-time or limited-term contracts. There is a state fund that would make credit facilities available to young people in precarious employment situations, but the banks are not availing themselves of these facilities.

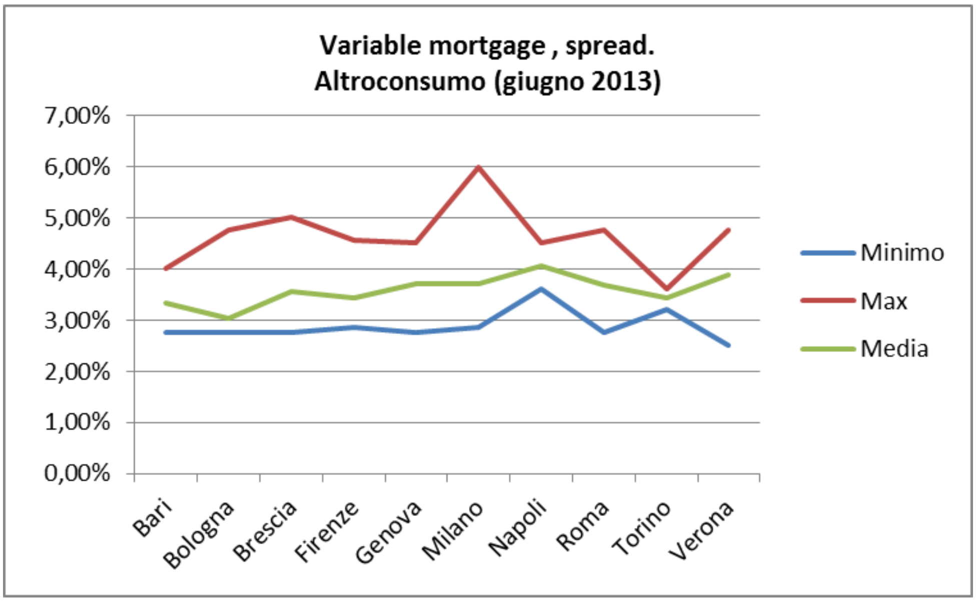
Mortgages in free fall: What is the problem?

The mortgage market in Italy is currently blocked, not only due to the drop in demand caused by increased unemployment and a reduction in household income, but also due to a tightening of supply by banks. Banks themselves have less access to funding and more budgetary constraints, as well as a perceived deterioration in loan quality, according to the Bank of Italy in a study published in early 2013.

However, Altroconsumo, believes that banks do not really have difficulty obtaining funds in the interbank market. Data from the survey of the Bank of Italy (Financial Stability Report, April 2013) shows that the difficulty of raising capital, which had been present until the first half of 2012 is no longer an issue. The same Italian Banking Association (IBA), in its report on the banking sector in 2013, said that in the second half of 2012 the reduction of credit was due to exogenous factors related to the economic crisis, and thus to higher-risk customers.

Investigative research conducted by Altroconsumo in 155 financial institutions in 10 cities in the form of mystery shopping trials demonstrated that few providers would grant credit to a 'normal' person (our secret shopper looking for a loan for 80% of the value of the home). The profile of the secret shopper was an employed individual earning 4,000 EUR/month. In 26% of cases, the secret shopper was denied a home loan mortgage for reasons such as: the need for an insurance policy; reluctance from the financial institution to issue new mortgages; and in some cases, the lack of professional staff available to discuss the specifics of the financial product itself. Also, a number of financial institutions visited by Altroconsumo didn't make any offer because the bank could only finance only up to 60, 70 or 75% of the appraised value of the property.

The geographical variations of the spreads applied to a 25-year mortgage are highlighted in the graphs below:



Cities	**Min. Spread**	**Max. Spread**	**Average**
Bari	2.75%	4%	3.34%
Bologna	2.75%	4.75%	3.03%
Brescia	2.75%	5%	3.56%
Firenze	2.85%	4.55%	3.44%
Genova	2.75%	4.50%	3.70%
Milano	2.85%	6%	3.70%
Napoli	3.60%	4.50%	4.05%
Roma	2.75%	4.75%	3.68%
Torino	3.20%	3.60%	3.43%
Verona	2.50%	4.75%	3.88%

A spread of 3.58% on average is excessive and spreads of 6% can be considered irresponsible. This means that, when market interest rates rise, the borrower who chooses a variable mortgage will be faced with a significant increase in their instalments.

Mortgage mirage: A guarantee fund created by the State but not truly available to anyone

Young people in Italy, especially if they have a fixed-term contract of employment, have very little chance of obtaining a mortgage. In most cases it is necessary to have an additional guarantor.

In 2011, a guarantee fund for loans for young people was launched by the Ministry of Youth and ABI with the main purpose to "allow young couples with sufficient income, but who are in limited term job contracts, to obtain a loan for the purchase of a first home, even though they may lack the guarantees usually required". The fund has been managed by Consap (a public insurance company).

The funding is supposed to be available to young married couples with or without children, or to single individuals if he/she has minor children. The grant beneficiaries must be younger than 35 years old and have an ISEE income (income determined by revenue and number of household members) of not more than 35,000 EUR. Other conditions are that the beneficiaries should not be owners of other residential properties. In addition, no more than 50% of the total taxable income for income tax purposes must be due to an employment contract for an indefinite period. This is to ensure that those with temporary work contracts can also apply to the fund.

The financing sought should not be for a luxury home; the surface area of the property must not exceed 90 square meters; and it must be the owner's principal residence. The amount of the loan must not exceed 200,000 EUR. The interest rate applied and the conditions of the loan are set by banks within the parameters permitted by the agreement between the Department of Youth and the ABI.

The loans can be signed with a maximum rate equal to or equivalent to Euribor plus 150 basis points for loans of more than 20 years, and Euribor plus 120 basis points for others loans, in the case of variable rate mortgages, as well as at a maximum rate equal to or equivalent to IRS plus 150 basis points for loans of more than 20 years, and to IRS plus 120 basis points for others loans, in the case of fixed rate mortgages.

The lenders also agree not to seek additional collateral or guarantees from the borrowers, in addition to the mortgage on the property and the guarantee provided by the State.

And if the borrower does not pay?

If the instalment is more than 100 business days past due, then the fund intervenes at the request of the bank. The guarantee fund would cover a maximum of 50% of the principal amount of the loan plus charges (max 5% of the outstanding principal) and contractual interest in an amount equal to the maximum legal rate. In any case, the maximum coverage would be 75,000 EUR/mortgage in default. For the remaining portion due, the bank would need to collect repayment from the borrower.

At present, there are 32 member banks participating in the initiative and to date, only 1.06m EUR has been committed of the 50m EUR fund to a total of 96 borrowers/recipients. This represents a drop in the bucket of those qualified persons seeking financing for homes. The banks that are participating in the initiative are many.[22] As part of Altroconsumo's investigative research, we visited participant banks and introduced ourselves as a married couple, he 30 and she 28 years old, with a total income of around 30,000 EUR/year (monthly income of approximately 2,500 to 3,000 EUR/month). Both husband and wife lacked a fixed-term contract; therefore, they qualified for the fund.

We visited 15 different bank branches for each of the cities visited: Milan, Rome, Bologna, Turin, Bergamo, Prato, Naples and Taranto. In total, we collected 177 mortgage deals. Out of the banks visited, however, only a few banks had joined the Guarantee Fund. The researchers received offers from only 71 (just over 40%) banks that are participating in the initiative. However, even at those banks participating in the initiative, 87% were unaware of its existence. The bank employees informed the two secret shoppers: "I do not know", "maybe it's better to ask in the region", "it is a new law, it is not yet operational", "headquarters has not sent any circular about it".

Thus, we received accurate information in only nine instances and were offered a spread with 1.20 or 1.50%, depending on the term of the mortgage. In other cases, the spreads were quite high. On average, we recorded a spread of 3.18% with peaks of 5.25% and frequent values of 4%. At that rate, instalments become unsustainable for most consumers.

The results from our investigation indicated that the information about the fund is not promoted by the stakeholders and partner banks (87% of the agencies of banks' 'affiliated' advisers knew nothing about the fund).

Pre-contractual information is little and opaque

Altroconsumo's investigative research shows that there is very little information disseminated to consumers or to bank staff with regards to mortgages as a financial product.

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[22] Bcc Monte Pruno di Roscigno e Laurino (Sa); Unicredit; Intesa Sanpaolo; Banca Popolare S. Angelo; Banca Popolare di Lajatico; Banca Sella; Banca Sella Nord est; Bcc Centro Emilia; Monte dei Paschi di Siena; Carige; Banca Antonveneta; Cassa di risparmio Biella e Vercelli; Bcc Bene Vagienna; Bcc Ostra Vetere; Cassa di risparmio di Savona; Banca di Piacenza; Cassa di Risparmio di Carrara; Bcc di San Giorgio e Meduno; Eticredito; Banca Popolare di Puglia e Basilicata; Bcc Federazione Siciliana; Bcc di Sant'Elena; Credito Bergamasco; Banco Popolare; Banca Popolare Pugliese; Banca Popolare di Milano; Ubi Banca; Banca Don Rizzo – Credito Cooperativo della Sicilia Orientale; Banca del Monte di Lucca; Banca del Centro Veneto; Bcc Gaudiano di Lavello; Banca Carige Italia; Cassa di Risparmio di Genova e Imperia.

Consumers do not necessarily have to purchase a mortgage with the same bank with which they have a current account. Indeed, today the bank that gives the loan cannot force consumers to open an account to deliver the mortgage. To compare, however, it is essential to find the operators in the bank willing to give enough information that is comparable. Collecting comparable and useful information is very difficult.

The module ESIS (European standardised form) that should serve just for comparison purposes is almost never issued. It is interesting to note that as part of Altroconsumo's investigative research for the 115 offers that we have recovered, 60% of the offers were delivered in the appropriate format.

Malpractice and binding sales

New measures have been introduced recently in favour of the consumer shopping for a mortgage to make the sale of the product more transparent, with no bundled or tied products. In practice, those seeking a mortgage cannot be obligated to open a bank account to obtain financing, or to buy an insurance of any kind sold by itself. If the bank tells the consumer something different, it should be reported to AGCM (the Italian Competition Authority online at www.agcm.it).

Unfortunately, these abusive practices remain widespread. According to Altroconsumo's investigation, in 80% of cases opening a bank account was presented as a prerequisite to obtain a mortgage. In 24% of cases, the bank requires the consumer to purchase its own life insurance policy. The costs are exorbitant, eg, for a 25-year mortgage of 240,000 EUR, insurance fees quoted were 19,000 EUR (Banco Popolare agency Bologna).

In addition, a fire insurance policy should be obtained, but banks cannot force the consumer to buy coverage from the bank issuing the mortgage. The consumer must have the option to choose the product elsewhere. Unfortunately, the unfair practices continue in 17% of cases.

Possible solutions and conclusions

How can a consumer obtain credit in a responsible manner? What should he do to overcome the obstacles to credit predominant in Italy today?

The sole solution cannot be that those who can't access credit can make a report to the Prefect (a potential solution introduced in late 2012). The law states that if a consumer has problems accessing credit, his report can be sent to the Prefect that, in turn, has the ability to activate the banking Referee. The latter, which is independent of alternative dispute resolution between customers, banks and other financial intermediaries, will have the task of checking whether the actions of the bank in denying credit was appropriate. Once the Prefect has received the message, it may ask the bank to give reasons for the denial of the loan.

If the bank's response is not satisfactory, the Prefect may require that an intervention by the Referee bank is required within 30 days. On the website of each prefecture there is also an email for the consumer to alert us. Additionally, an observatory was established which reports to the Ministry of Economy and which is charged with monitoring the loans provided by the banking and financial sector.

However, these measures are inadequate. It is interesting to note that to date no case has come to the attention of the Banking Arbiter. Therefore, it is an instrument which seems wholly unable to address the issue of a blocked credit market for mortgages.

What do consumers need? In our view, the market at present has failed. State intervention is necessary to facilitate access to credit and to encourage investment and consumption, and then GDP will grow. Otherwise it will trigger a downward spiral for an already ailing economy: less credit equals less investment, and ultimately less work (despite the Italian Constitution guaranteeing the right to work in Article 4). Less work means even less income; and so the downward spiral becomes a tsunami for consumers.

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Chapter 8

Responsible lending in Malaysia

Paul Selva Raj, Secretary General, FOMCA

Banking system in Malaysia

The banking system and financial institutions play a very significant role in the economic development of Malaysia. Through an efficient banking system, the consumer can benefit in two ways: by having a safe place to save money and being able to access credit for purchasing larger items such as houses or cars. Credit cards also enable a convenient system of payment for the consumer.

Bank Negara Malaysia, the Central Bank of Malaysia, is at the apex of the monetary and financial structure of the country. The principal objective of the bank is to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. To achieve its mandate, it is vested with powers under various laws to regulate and supervise the banking institutions and other non-bank financial intermediaries. There are a total of 22 commercial banks and 17 Islamic banks in Malaysia.

Among the main regulations and guidelines issued by the authorities to govern the financial system in Malaysia are the Banking and Financial Institutions Act (1989), the Exchange Control Act (1953), and the Anti-Money Laundering Act (2001). Recently, the government approved the Financial Services Act (FSA) (2013); this new legislation will give the financial regulators stronger and tougher powers aimed at better governance, including checks and balances to better supervise financial institutions.

The Act aims to bring about more transparency, accountability and governance in the Malaysian banking sector. Another goal is to make ensure that institutions have sufficient assets to meet their obligations.

One area of particular importance to consumers is that agencies that were previously outside the Central Banks' regulatory framework and regulated by other agencies which were often not as effective as the Central Bank, will now come under the Central Bank's jurisdiction.

The FSA will also bring about stricter penalties for financial crimes. Because the legislation is new, the implications for consumers generally remain to be seen.

Banking issues and complaints

Based on reports from the National Consumer Complaints Center (NCCC) and a focus group on consumer banking issues conducted by the Consumer Research and Resource Center

(CRRC), the complaints and issues faced by consumers in the relationship with the financial sector are as follows:

Complex products

Finance products are often too complex to understand. Thus, consumers have a difficult time making informed decisions in their best interests. As they do not understand the products, often they rely on banking agents to advise them on the “best” product. However, agents may be more motivated by commissions rather than the best interests of the consumer, resulting in consumers getting poor advice, which unfortunately is not usually apparent in the short term, but may have grave consequences in the long term.

Second, the complexity of the products means that consumers have great difficulty comparing products from various providers to get the best value for money. Thus, they rely on banking agents’ advice.

Bank Negara encourages all banks to have product disclosure sheets for their products, which is a great step forward to enable consumers to have a better understanding of financial products. More importantly, it enables consumers to compare products to get the best value for money.

Banks are obligated to provide product disclosure sheets for all credit products. Products selected for this are quite comprehensive; home financing, vehicle financing credit cards and personal financing. Additionally, according to Bank Negara’s guidelines, marketing staff are required to explain key information to consumers. The guidelines also specify that marketing staff should be properly trained, and bank remuneration policies should promote responsible marketing practices.

Bank charges

Consumers too often complain about being charged for items about which they have never been informed. Whether it is for loans, credit cards, current accounts, or currency exchange, they are often charged for items not explained to them by banks. It has even been reported in the local media that exorbitant and manifold bank charges are the number one complaint by consumers against banks.

Sometimes when the consumer or the NCCC registers the complaint with the bank, the charges are reversed. There are, however, many consumers who do not make complaints, or do not know how to effectively complain; thus, the banks profit unjustly. Banks are also unjustly profiting from the consumers lack of attention to their accounts, and inability to identify discrepancies and to take action to resolve the issue.

Rejection for use of banking facilities

Banks sometimes reject applications for opening accounts or access to credit. While banks may be justified in rejecting the application, what is disconcerting is that no reason is given for the rejection. The consumer is left to wonder and speculate as to why his application is rejected, thus impacting his welfare.

One common reason for rejections, though often not acknowledged, is that the consumer's name is on the CTOS (Credit Tip off System) list. The moment a name is listed in CTOS, the consumer's application is rejected. CTOS does not update its list, and thus the information is often incorrect and out-of-date. It might even be for a non-payment of a loan that happened more than 20 years ago; but which has been settled long since. Clearly, it is a violation of the consumer's rights for a private company to use his data without his consent. Also, it is unethical and, with the new Data Protection Act, even illegal to use information about a person without his consent. Yet the use of CTOS data, though not acknowledged, is used widely to the detriment of the consumer.

And, if a bank is to reject a consumer's application because his name is on the CTOS list, at the very least, the consumer should be informed so that he can take the necessary action to correct or update the list. Again the transparency of the bank in the rejection of any loan applications is critical to enhance consumer's welfare.

Standard procedures for auction

While consumers may default on their monthly payments for loans taken due to various personal reasons, often the procedures taken by banks to auction properties are grossly unfair to the consumers. Banks should give priority to the welfare of the consumers since they have more rights to the property.

The NCCC has received many complaints regarding auctioning. While the provisions of auctioning are often stated in the loan agreement between bank and consumer whereby the bank claims the right to auction properties when the consumer defaults his loan, often there is conflict about the notice of auctioning. The customer will often claim that he did not receive notice; while the bank will claim that it has sent the notice. Claiming that the bank was unable to contact the consumer, the bank will go ahead with the auction.

The second issue in auctioning is that of the fair value of the asset. There have been accusations that banks sometimes collude with bidders, and sell the property below the market value. The consumer thus gets less than the market value, and may even have to top up the remainder if the sale price does not cover his loan obligations.

There clearly needs to be better oversight and enforcement by the regulator to ensure that consumers get a fair deal in auctioning of properties.

Outsourcing of collection by banks

Banks often assign consumer's debt to third parties to make collections. These third parties are not regulated by any banking laws and are notorious for using harsh and aggressive methods in collecting the debt, to the detriment of the consumer. Bank Negara has often stated that although the third parties are independent, the banks concerned will be held responsible for their inappropriate and aggressive conduct. These collection agents themselves should be regulated and the banks concerned should be held accountable for the actions of these parties.

While certainly there may be criminal complaints raised against the aggressive parties concerned, one should also realise that the consumers themselves may feel insecure because he did not make the loan payments to the banks. There have been some news stories about the harassment and aggressive actions of these parties, but generally consumers are very vulnerable to this kind of aggressive behaviour.

Status of household debts in Malaysia

Malaysians often have easy access to credit. This has resulted in substantial household debts. Household debt to GDP stands at 83%, which is considered to be one of the highest in Asia. Most of the household debt comprises housing, car and personal loans. According to a Bank Negara report in March 2013, the household debt composition of the financial system is allocated as follows: 45% for purchase of residential properties; 18% for vehicle purchase; 17% for personal use; and 4% for credit cards.

There is a debate on what is the cause of this dire situation. One view says that many, especially young workers, are living beyond their means. Others disagree, saying that the cause is high asset prices and relatively low incomes.

One clear issue is that property values are increasing to an all-time high. While a new graduate employee may earn an average of 2,500 MYR/month; a new property in the Klang Valley can cost up to a minimum of 250,000 MYR for a single-room apartment. While it may be possible to rent homes; rental prices themselves can be relatively high. For example, a two-room apartment can be priced at about 800 to 1,000 MYR. Thus, a new graduate who finds a job may pay half his earnings to monthly rent.

It should also be noted that young consumers aspire to own their own homes, and the societal pressure to do so may result in purchasing homes when they can least afford to do so.

While the government is encouraging banks to loan to first-time home buyers, the banks are generally quite reluctant because it means they have to take greater risks. The government has sought to build some affordable housing; though the numbers do not meet demand by any means.

However, generally young workers feel that homes in the urban areas have become too expensive for them to afford.

Tightening consumer credit

To tighten credit, in November of 2011, the Central Bank established new guidelines on responsible finance. The aim of these regulations was to “avoid excessive household indebtedness and to reinforce lending practices by credit providers”.

The objectives of the guidelines are to:

- Inculcate responsible lending practices by financial institutions in their dealing with individual customers;
- Promote responsible lending and borrowing behaviours to foster a healthy and sustainable credit market which in turn contributes to economic and financial stability; and
- Further strengthen the protection of consumers’ interests.

The scope of the guidelines encompasses all new and additional financing to individual consumers on home financing, vehicle financing, credit and charge cards, personal financing and financing for purchase of securities.

The guidelines emphasise more stringent “sustainability and affordability assessments” on consumers. The financial institutions need to ensure that customers are offered financing products that they can afford to repay; in full throughout the financing tenure, without recourse to debt relief or experiencing financial hardship.

While these measures are called “guidelines”, Bank Negara often enforces these measures through various administrative instruments in its capacity as regulator. One such requirement is that income considered should be based on net, rather than gross income. The debt service ratio for civil servants was set at 60%. For other sector employees, the banks can use their discretion.

Another requirement is that bank policies should be prudent enough to prevent customers from becoming over-indebted. Banks should ensure that there should be sufficient buffers for the customer’s daily and essential expenditures and contingencies, having regard to the relevant circumstances of the customer. Generally, banks adhere to these guidelines.

Since January 2012, banks must communicate to borrowers the implications of the loans they take, illustrating to consumers just how much they will have to pay should the base lending rate go up. Additionally, to enable consumers to make more informed decisions on products, a product disclosure sheet providing key information on various borrowing terms was introduced, including: the financing amount, tenure rate, payment obligations, fees and charges, late payment charges and avenues for redress and assistance.

In 2011, Bank Negara also tightened the credit card guidelines. The minimum income requirement to acquire a credit was raised from 18,000 to 24,000 MYR/year. Second, card holders earning less than 36,000 MYR/year could only hold cards from a maximum of two card issuers, and the maximum credit limit is two times the monthly income of the cardholder per issuer.

Despite these guidelines, FOMCA feels that banks, especially through third-party marketing agencies, are aggressively marketing their credit cards, and not strictly adhering to the Bank Negara guidelines.

On July 2013, the bank further tightened lending rules. They reduced the maximum period of payback of the home mortgage and personal loans (from 45 to 35 years for mortgages and from 25 to 10 years for personal loans).

Despite the many measures to rein in household debt, the data shows that it is actually getting worse. Malaysia's household debt stands at 83% of the nation's gross national product. This may be one of the highest in this region; with housing loans and car loans comprising the bulk of household debt.

Conclusion: Model on fair dealing to consumers

While Bank Negara has guidelines which banks must adhere to, individual banks often have their own code of conduct for their internal management of their processes. And, some banks will indicate to the consumers the expected time frame for any application made to the bank.

Two additional steps that regulators should be taking are: first, to enforce guidelines to enhance consumer welfare such as those in place in Singapore. The Monetary Authority of Singapore has passed *Guidelines on Fair Dealing – Board and Senior Management Responsibilities for Delivering Fair Dealing Outcomes to Customers* which deal with appropriate business conduct.[23] These guidelines could be an appropriate framework for Bank Negara to enforce on the local banking system.

The number of complaints in the media and those received by the NCCC in relation to complaints by consumers about their relationship with the banks are increasing

[23] The five *fair dealing* outcomes in place in Singapore are:
Outcome 1: Customers have confidence that they deal with financial institutions where fair dealing is central to corporate culture.
Outcome 2: Financial institutions offer products and services that are suitable for their target segments.
Outcome 3: Financial institutions have competent representatives who provide customers with quality advice and appropriate recommendations.
Outcome 4: Customers receive clear, relevant and timely information to make informed financial decisions.
Outcome 5: Financial institutions handle complaints in independent, effective and prompt manner.

dramatically. Instead of a reactive mode of dealing with the complaints, a more proactive regulatory framework would ensure better consumer protection and enhanced consumer welfare.

The second step that the regulator should take is to implement financial education programmes for all consumers. While FOMCA is collaborating with Bank Negara on some financial education programmes, there are also several agencies which undertake financial education programmes. FOMCA strongly feels that these ad hoc approaches are ineffective and has thus proposed the formation of a Financial Education Commission to coordinate and allocate sufficient resources to undertake a comprehensive national financial education programme.

Chapter 9

Consumer lending practices in Russia and its effects on Russia's consumers

Elena Wolf and Tatiana Vodopianova, KonfOP

The Russian consumer credit landscape

Consumers in Russia do not have the legal right to restructure their debt, should they find themselves over-indebted. No legislation has yet been adopted allowing for personal bankruptcy filings. And, since the 2008 financial crisis, a number of Russian banks began to increase rates on previously-issued loans. For many in Russia who had experienced some sort of a credit boom, it was an unpleasant surprise. State support for borrowers resulted in the proposal entitled 'United Russia' to freeze payments on loans for people who had lost their jobs. Fortunately, increasing interest rates did not become a mass phenomenon, as it only affected mortgage and car loan markets, whereas the most wide-spread loan products in Russia were still personal loans and credit cards. Consumer credit offers were quite abundant with interest rates varying from 28 to 70%.[24]

In 2010, legislation was passed forbidding retroactive changes in contractual terms, unless it is specifically stipulated in the contract that the interest rate may vary. During the last four years the volume of consumer credit grew at a rate of more than 30%/year. The interest rates remain unreasonably high and millions of people in Russia are borrowing a total of 250bn dollars through credit cards and for cars. However, it is interesting to note that mortgage borrowing constitutes only 15% of the total consumer loan market.[25] Consumer organisations advise people to abstain from taking out new loans, because the new loan products have become unreasonably expensive.

During and after the 2008 financial crisis, the Agency for Housing Mortgage Credit gave funding to private banks and the Commission for the Restructuring of Debt was created to help people who borrowed through this state housing mortgage programme. The Commission no longer exists, as with the average interest rate on mortgage borrowing as high as 13%, the demand for mortgage borrowing is quite low. There is also a Credit Bureau, which was established following the enactment of legislation on credit bureaus 10 years ago. However, the payday lenders are not obliged to obtain or share information with the Credit Bureau, and as a result, other lenders are unable to ascertain the real debt burden of an applicant for credit.

The payday loan market is relatively young in Russia and was formed around the time of the last crisis (2008-2009). The target customers for payday lenders are usually people with no

[24] Interview with Dmitriy Yanin, Chairman of KonfOP.

[25] Interview with Dmitriy Yanin, Chairman of KonfOP.

college education, low to medium income, who are ineligible for bank loans and are financially illiterate. The majority of payday loan customers take out the loans to cover expenses such as public utilities and food with the interest rates varying from 1 to 3%/day.[26]

As mentioned, legislation on personal bankruptcy has not yet been adopted in Russia. A business venture can claim bankruptcy; but despite several years of consideration by the legislature, the personal bankruptcy law has not passed. In fact, there have been cases of debtors passing on their property and with it, the mortgage on the property to their children. These heirs, when they become adults, are then liable to pay this debt and are unable to claim bankruptcy if the value of the property does not cover the debt.[27] The law on individual bankruptcy is very important too for over-indebted individuals with no property, as well as those who inherited debt to start adult life.

Russian consumers are relatively new to credit services because the banking sector was only liberated following the break-up of the Soviet Union. The first private banks were created in the late 80s and only since 2002 and 2003 have banks begun to offer consumer credit. Since the late 1990s and until 2003, banks borrowed from consumers offering deposit accounts and issuing credit to businesses.[28] The novelty of credit products has been coupled with the novelty of advertising and a general lack of financial literacy amongst average Russian consumers, which has led many people to take on credit they cannot afford, or to accept credit offered without fully understanding debt repayment obligations, such as the terms of the mortgage, actual interest rates and penalties for late repayment.

The Bank of Russia plans to impose regulatory limits on the share of total income that citizens can spend on loan repayments. The new index will reflect the ratio of debt compared to the income of the borrower. Whilst it is not clear how this initiative will be implemented, the options under consideration are to set the maximum debt, or ban the issuance of loans in excess of the established values of the index, or to introduce a system of rigid reserve requirements. The initiative is under consideration due to a significant increase in the debt burden of consumers.

In 2007, people spent 5.6% of monthly income on average to service their debts, and by 2013 this figure had doubled, reaching 11.8%. This is a cause for serious concern. Some borrowers are spending 45% of their income on credit repayments. Debt is not only growing, but is becoming more expensive and short-lived. Before the 2008 financial crisis, the share of car loans and mortgages was 47%; after four years, it became 37%. Many financial experts consider that the initiative is extremely difficult to implement due to the presence of irregular and ‘grey’ income and the need to consider income from households rather than income from individuals only. Alternatively, experts recommend that banking institutions

[26] Examples of payday lenders such as Kukuruza, Migcredit, Dengi naprokat.

[27] Civil Code of Russian Federation.

[28] Interview with Dmitriy Yanin.

should be provided with access to the state pension fund data, which would allow an individually-tailored approach to each customer.[29]

When reviewing consumers' applications for credit, bank staff are not conducting an analysis regarding whether the consumer can repay, or whether the product is suitable for the consumers' needs as a responsible lender should do. Bank personnel instead appear to be principally motivated by receiving incentives to sell high volumes of debt at high interest rates, which allow banks to make profits even if consumers default.

KonfOP is currently implementing a project monitoring financial services in the country with the support of the Russian Ministry of Finance and the World Bank. It is interesting to note that only a quarter of the 20 banks surveyed[30] during the pilot phase of the project asked potential borrowers about the proposed use of the funds, their level of education, employment, income and expenses, or evaluated the consumers' ability to repay. When issuing credit cards, only a quarter of surveyed banks asked questions about income, and none of the banks verified by asking for proof of income.

Current problems with regards to consumer credit in Russia can be summarised as follows:

- Hidden commissions;
- Bundled services which don't offer any benefits to consumers such as life insurance, property insurance and prepaid insurance;
- Misleading information on available loan services;
- The absence of legislation for regulation of collectors' agencies;
- The absence of personal bankruptcy; and
- Undisclosed information regarding the true cost of credit.

Cases of lack of transparency and information disclosure

During the pilot phase of the above-mentioned project, instances of lack of transparency and information disclosure were also exposed with regards to three financial products examined: mortgages, unsecured consumer credit and short-term loans.

The examples listed below are drawn from the pilot research conducted in Moscow, Kaliningrad, Volgograd and Tver. The research methods used included evaluating websites, making on-site visits to lenders, and conducting mystery shopping.

[29] August 1, 2013 onine.equifaxx.ru/articles/show.id/349

[30] Twenty of the largest banks were visited in the course of the pilot phase of the project with 2-3 visits to different branches per bank.

Mortgages

None of the 20 leading banks in the mortgage market published information on their websites on annual effective interest rates, making it impossible for the consumer to find out the true cost of credit without visiting the office of each and every bank. Only three banks provided tentative examples of how the interest rate is calculated. Current regulations require disclosure of the manner by which the interest rate is calculated only at the stage of signing the contract but there is no common agreed method for doing this (eg, APR or EIR).

KonfOP would therefore recommend that this information be revealed much earlier in the borrowing process and clearly communicated on banks' websites as well as in all other marketing communications.

Banks in general discriminate against customers who choose not to take a life insurance policy offered by the bank. This increases the cost of credit by 0.61 to 5%/annum despite the fact that all mortgages are secured by insured collateral, ie, banks have other forms of securing consumer obligations. Banks in the past dictated which provider would be used; however, currently they offer a list of providers. Nevertheless, consumers are only able to vaguely understand what is covered by the insurance they are paying for as the conditions in the policy supplement called 'insurance rules' are so long and contain so many exclusions and technical language that consumers find them difficult to read.

KonfOP recommends that insurance contracts also contain summary boxes of the main terms and conditions including exclusions.

Half of the 20 leading banks charge a one-time commission for credit issuance which is from 0.5 to 2.1% of the amount of credit without disclosing information on annual effective interest rates on their websites. This practice affects the cost of the mortgage.

Only a fifth of surveyed banks provided consumers with a choice of the form of credit repayment. The annuity method is common, but consumers are not informed of its drawbacks. Bank staff instead draw the attention of consumers to the affordability of the annuity method without informing them that they would be paying interest in the first few years of the mortgage, and only towards the end of the mortgage would they be paying towards the value of the property (which makes it impossible to sell property should one have to do so without losing most of the money paid). There is another repayment called the 'differentiated method', where one pays off both interest and the property value simultaneously. However, the payment is structured so that at the beginning of the mortgage, the monthly payments are higher and diminish with time. This method allows consumers to see how much is contributed to property and how much is contributed to paying off interest. However, as the payments in the beginning of the mortgage are high, few consumers are able to afford it.

The picture is an example citing a consumer credit offer of 0% APR for the first four months and 34% APR from month five with a warning that in case a customer elects not to use the insurance bundled with this offer, the yearly APR is 40%.

It is important to note that when there is regulation the banks do tend to adhere to it. For example, all leading banks in the mortgage market disclose information on possible free, early repayment of credit, which is stipulated by the requirements of the law 'On Banks and Banking Activity'. This is an example that banks adhere to legislation that exists. *Most of the problem areas in financial services in Russia are due to inexistent or ineffective legislation.*

Microfinance and payday loans

Microfinance organisations provide no information on annual interest rates. Offers related to payday loans are difficult to compare with bank loans as they usually state a daily loan rate, or inform the consumer of a final sum to be paid with interest.

A payday loan may be extended for an unlimited number of times. Extension of a payday loan for a term of more than one month was available at the majority of the surveyed micro-financing institutions. A short-term loan may apply charges 50 times higher than bank interest rates, and so may easily become a long-term, high-interest rate credit for a consumer.

There have also been instances where **consumers have been compelled to take on additional services** such as life insurance when taking out relatively small loans.

There are instances of misleading branding. The appearance of sales offices at several microfinance institutions is often similar to the interior of the largest banks in Russia. This causes confusion to consumers especially in situations when consumers are making deposits. The microfinance institutions are using bank terminology and misleading the public to believe that deposits are 'guaranteed" and "insured" when in fact they are not because the microfinance institutions are not included in the state insurance system covering the banking sector.

There are instances of questionable co-branding programmes with fidelity, debit and phone cards. One of the largest mobile phone operators, Evroset, co-branded with a microfinance organisation, Migcredit, to offer phone-card, Kukuruza, which in time becomes a credit card with payday loan conditions. If a consumer runs out of funds on the card, it transforms into a credit card with APR of 1-2%/day.

Consumer loans

Neither banks' websites nor advertisements for consumer loans contain information on the full cost of credit. The actual cost of credit products may include all or some of the following: annual credit interest, card service fee, commission for credit repayment at the bank's cash desk or via an ATM machine, or insurance.

For example, advertising materials of financial institutions could mislead consumers by stating that an unsecured loan may be obtained at a rate starting of 11.8%/annum, even though actual costs of obtaining such loan may be 70%/annum inclusive of other fees and charges.

It is also worth noting that marketing communication of loan conditions are significantly different from the actual conditions offered when consumers apply for a loan.

Consumers also pay very high penalties for late repayments. According to the Central Bank of Russia, overdue debt of individuals for the last three years has remained quite low as compared to other countries – 5.2% of the entire consumer debt volume is debt that was not paid on time. This may be due to very high penalties for late repayment of loans, for example, a fixed penalty for a late payment often exceeds the balance of the debt. The lowest penalty rate is 48% of the annual size of the loan; the highest is 365% the size of the loan. The size of a fixed penalty can be 5,000 RUB for a late payment plus 180%/annum accrued on the unpaid amount.

While sales consultants are generally eager to provide consumers with colourful leaflets and presentations, the following important information gaps are evident:

- Most banks draw the attention of consumers to the amount they are liable to return to the bank rather than providing APR, which makes it difficult to compare the loan to other offers as the duration of loans vary; and
- Not a single credit offer amongst the surveyed banks contained the cost of credit calculated with all costs of additional bundled services and commissions.

KonfOP's contribution towards making consumer lending more responsible

KonfOP has been actively participating in various debates to advance financial consumer protection for more than 10 years and the organisation has advocated for the adoption of the law 'On consumer credit', which was passed in April 2013 after seven years of debate.

At present, KonfOP is participating in discussions regarding adopting amendments to the law 'On Banks and Banking Activity', with the aim of harmonising the consumer information requirements regarding the terms of contracts, as well as acts aimed at harmonising the regulation of collection agencies with those of EU legislation.

KonfOP is also advocating for the adoption of legislation on personal bankruptcy. KonfOP participated in the discussions on personal bankruptcy at the Presidium of the State Council under the President of the Russian Federation in January 2012 advocating for the revision of the draft law on personal bankruptcy. However, this work has not yet brought the expected results. KonfOP believes that the changes it is advocating will provide the foundation for one of the basic consumer rights – the right to be informed.

It will also make a valuable contribution in the banking sector in the following ways:

- Improve competition in the banking sector;
- Decrease the risks of non-repayment by consumers; and
- Increase the sustainability of the banking sector in Russia.

Chapter 10

Responsible lending in Slovenia

Boštjan Krisper, Head of Financial Services, ZPS

Usurious nonbank loans in Slovenia

The economic downturn of the last five years has led to an increase in unemployment and an overall decrease in household incomes in Slovenia. At the same time, access to credit has become more restricted by banks which have become more conservative in approving consumer loans. Thus, many consumers with low income and part-time or fixed-term work contracts are basically excluded from access to credit.

As a result, consumers whose credit requests are turned down by the banks are increasingly turning to non-bank lenders, where risks of predatory practices are considerably higher. Typically, consumers are looking for smaller amounts of money that they plan to repay at the end of the month, or within a year. Often, such short-term loans come with very high interest rates and late-payment penalties. As a result, many consumers see their original debt grow to unsustainable levels – from a few hundred to a couple of thousand EUR.

In theory, Slovene law protects consumers from the exceedingly high costs of credit. In the early 2000s in the face of widespread usurious practices, the government limited the average percentage rate (APR) of nonbank loans to 200% of the average APR of bank credit. Twice a year, a list of average bank APRs is published for six typical loan amounts and maturities, thus limiting the maximum cost of nonbank credit.

And, in 2011, this rule was extended to short-term loans in order to limit the high costs of payday lending and SMS loans that started to emerge during the economic crisis.

Despite these strict rules on the cost of credit, irresponsible lending by numerous small companies continues as the demand for nonbank credit has also skyrocketed. Due to low capacities and lack of legal authority for action, the Slovene Market Inspectorate, which is the responsible authority for supervision of the nonbank credit market, can only react to individual consumer complaints. It is not able to consistently and proactively supervise the market conduct of credit providers due to capacity constraints. And, when it revokes the licence of a particular creditor because of illegal activity, a new company quickly emerges in its place.

Further, consumers often have difficulty exiting illegal contracts because in Slovenia it is typical that the consumer’s employer, or the state pension fund (if the consumer has already retired), issues an administrative statement that effectively subtracts the monthly credit payment from the consumer’s salary or pension, and pays the sum to the credit provider directly. This administrative statement serves as additional insurance to the creditor and is usually the condition precedent for granting credit. And, even if the national supervisor has recognised that a specific credit contract is in violation of the consumer's rights, the consumer cannot annul the automatic deduction from his salary or pension without a court order. And, by that time, most consumers are in a weak financial position and cannot afford a lawyer to take the creditor to court, or to await a court decision that could take a few years.

ZPS has successfully campaigned for the introduction of the above-mentioned cap on APR, and the subsequent extension to the cap for short-term lending. ZPS has also requested that the government act to improve the underlying situation for affected consumers. The foremost intervention is to have a more pro-active supervision of provider conduct in the nonbank credit market. Better coordination of activities between key authorities such as the Market Inspectorate, police and tax inspections is also needed, as well as the abolishment of the administrative statements authorising automatic debits from consumers' salaries and pensions.

Because of austerity measures and a pre-occupation of the government with the financial crisis, the consumer protection response has been unsatisfactory to date. Besides calling for urgent government measures, ZPS is providing poor households and pensioners with free legal assistance in taking the usurious creditors to court. The following are two recent cases that ZPS brought on behalf of consumers:

- Consumer A borrowed 4,000 EUR for 12 months. The APR was 90.99% instead of the maximum allowed cost of 18%. When the case was brought to court, the consumer owed 9,500 EUR.
- Consumer B borrowed 2,000 EUR. His contract stated that he would repay the loan within a month, however, verbally it was agreed that he would make monthly instalments. The punitive fee for "late" repayment is 2,200 EUR. This is a circumvention of the rules on maximum credit cost. With interest on arrears, the consumer owed about 5,000 EUR by the time he went to court.

For a court claim valued at 4,000 EUR, the filing fees would be about 300 EUR and the lawyers' fees in the range of 450 EUR. Thus, it is easy to see how an over-indebted consumer, already victimised by predatory lenders, can not afford justice. ZPS is providing a public service, but does not receive government support for its advocacy. Rather, it funds these activities through membership fees.

Adjustable rate mortgages

Slovene households are also exposed to interest rate fluctuations, because about 95% of mortgage credit is variable interest rate loans. Similarly, households that take foreign currency mortgages are also at risk. Foreign currency loans constitute about a quarter of the entire mortgage debt.[31]

In Slovenia, there is a lack of rental property which aggravates the problem. Thus, buying an apartment is often the only solution for a young person. In 2011, for example, the apartment ownership rate was 77%, while the rate of rented apartments was 9%.[32] Because of this, many young people have over-extended themselves by taking home mortgages, and as a result, any decrease in income or increase in their debt repayments due to interest rate fluctuations can quickly lead to repayment problems.

Since the beginning of the financial crisis, banks in Slovenia have been increasing their margins, and that, with a reference interest rate (typically Euribor), equals the adjustable credit interest rate. This is due to the fact that the Euribor doesn't reflect their actual costs of lending. Thus, it seems that financial institutions are not taking into account whether the consumer will be able to repay his loan when the Euribor rises to pre-crisis levels. And, because most mortgages have a maturity of more than 20 years, it is very likely that a rise in Euribor will endanger the consumers' ability to repay his debt in the future.

A typical margin on the interest rate for an average consumer mortgage is presently 3%, while it was approximately 1.5% before 2008. While the current interest rate of such a mortgage is relatively low due to very low Euribor, a rise in Euribor to pre-crisis levels (eg, 4% in 2007) would cause a significant increase in the consumer's monthly instalment. This problem is especially serious because in general relatively low levels of income in Slovenia combined with mortgage debt have already caused a decrease in discretionary household budgets.

The solution for this problem would be to protect the consumers from high reference interest rate rises just like the bank is protected from interest rate falls (by the fixed margin). As selling of foreign currency mortgages for consumers receiving their income in EUR will unfortunately not be restricted by the new mortgage credit directive[33] similar solutions could be possible for protection against hikes in exchange rates. ZPS is advocating for the national banking supervisor and the European Banking Authority (EBA) to protect the consumer interest in EU member states where mortgages are based on an adjustable rate, or where foreign currency lending is common.

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[31] Bank of Slovenia, Financial Stability Review 2012, p.18.

[32] Statistical Office of the Republic of Slovenia, http://www.stat.si/novica_prikazi.aspx?id=4420.

[33] The European Parliament was against such a restriction, while the European Systemic Risk Board recommended that such risks can be mitigated through providing better information to consumers. The new mortgage directive will not bring considerable improvements for consumers. In Slovenia, at least not on this particular issue.

Supervision without consumer protection

None of the financial sector supervisors have consumer protection as part of their mandates. The banking supervisor acts in line with the consumer interest only on basis of provisions in sectoral financial services law (eg, consumer credit, payments) that has been to a considerable degree harmonised in the EU. However, because EU consumer law doesn't define how a financial supervisor should exercise its oversight, the supervision focuses on the prudential regulation of banks; such as capital requirements and liquidity, while supervision of the business conduct of banks is neglected. The financial supervisors are not pro-actively reviewing whether the providers are following the provisions in the legislation or whether practices detrimental to consumers are taking place on the market.

Consequently, legislative violations go unnoticed by the regulators, and the credit markets are not working to the benefit of consumers. For example, due to a lack of transparency at the pre-contractual phase and due to anti competitive/unfair bundling of products, it proves very difficult for consumers to estimate the real cost and riskiness of a particular credit product, or to compare credit offers at all.

According to ZPS, the existing system is unsatisfactory because the banking supervisor can only act in the consumer interest when it impacts the stability of the banking system (eg, through reputational risks). The supervisor should have additional authority to supervise the business conduct at all phases of the contractual relationship (eg, advertising, pre-contractual information, sales process, relationship management and debt collection), including a task to pro-actively monitor the provider behaviour, evaluate it from the consumer protection perspective and intervene when necessary.

Further, responsible lending should be encouraged by publishing penalties for breaches of consumer rights. Despite consumer advocacy on this issue, strengthening consumer protection in financial services has not been recognised as a priority for the Slovene government. In order to ensure a satisfactory level of consumer protection supervision in all the EU member states, the European Supervisory Authorities should define a minimum level of supervision by all national supervisors.

No national policy on over-indebtedness

The number of over-indebted households has been increasing in Slovenia since the beginning of the economic crisis in 2008. Despite this, Slovenia still lacks a national strategy on prevention and combating over-indebtedness, while over-indebted consumers are often left without any assistance. Household debt, as well as lending in Slovenia, are still below the EU average, particularly when the debt-to-income ratio of mortgages is at issue.

However, financial assets of Slovene households are also relatively low, which means that their safety buffer in the event of trouble with debt repayment is miniscule. In terms of arrears, the European Union Statistics on Income and Living Conditions (EU-SILC) data show that the level of Slovene households that are late with payments of their regular obligations is more than one and a half times the EU average.[34]

A long awaited measure – the consumer insolvency procedure – was introduced in Slovenia in 2008 and is being used by a growing number of households. The procedure results in debt relief for the consumer after five years.[35] The cost of the procedure is around 1,500 EUR, and can be covered by legal aid in case the household's income is too low to be able to afford legal assistance. A negative consequence of this system is that consumers with a relatively higher income, but who are still in a difficult situation because of high debt, cannot file for personal insolvency because they cannot afford it. There is also a shortage of free legal aid available due to the court's budget constraints as a result of the austerity measures.

Unlike in most of the older EU member states, no specialised advice for indebted consumers exists in Slovenia. As a consequence of the inability to resolve their problems, many households under financial strain slide into over-indebtedness, or remain over-indebted for a longer period than necessary. Because the demand of households for such assistance will presumably increase in the future with the austerity measures and unfavourable economic situation, it is urgent to develop debt counselling centres, as well as foster cooperation between the public sector and civil society working on consumer protection and social assistance. Banks and other creditors in Slovenia are obliged to assess the credit worthiness of the consumer before granting credit by the EU's 2010 legislation on consumer credit. In addition to the requisite evidence from the consumer, providers can also use the credit bureau data on consumer's use of financial products and any delays in payment in recent years. Because of the current aversion of banks to granting credit to consumers, it is still difficult to estimate whether these legal provisions will lead to more responsible bank behaviour when granting credit in the future.

[34] Directorate General Health and Consumers, European Commission: Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact, 2012, p.2.

[35] There is no provision of the minimum share of the debt that needs to be repaid. During these 5 years, the consumer needs to do his utmost to repay the debt. A special "trustee in bankruptcy" is assigned by the court, and controls the consumer's efforts and monitors whether all the financial gains of the consumer in this period that are above the monthly minimal wage are assigned for repayment of creditors.

Prior to 2010, banks had been granting credit to consumers without a proper assessment of credit worthiness, in particular without considering the risks of issuing long-term credit in Swiss Francs (CHF). Even worse, foreign currency credit, because it was cheaper than national-currency credit at the time of issuance due to low LIBOR reference interest rates, was often provided to financially weaker consumers, who otherwise wouldn't be able to pay the monthly instalments. When these instalments increased due to the strengthening of the CHF/EUR exchange rates, financial pressures increased significantly for consumers repaying their mortgages in foreign currency. Until now, the banks have placed blame on the consumers and claimed to have properly informed them of the risks of foreign currency credit. According to the findings of ZPS from consumer complaints, however, typically no information was provided to consumers on currency risks in the sales process, while a declaration on the provision of information on risks was formally provided in contracts in small print in order to protect the bank from potential legal claims.

In general, bank practices in Slovenia do provide the consumer who fails to meet his debt repayment obligations with a possibility of a moratorium on repayments (while interest accumulates), or of debt restructuring by an increase in loan tenure that lowers the monthly repayment burden. Still, if a consumer is forced to default on loan repayment due to unexpected factors (eg, unemployment, divorce or illness), he is expected to bear the entire burden, unlike in other EU states whereby both parties to the contract bear such risk.[36]

This is especially problematic for households that clearly won't be able to repay their debt, but at the same time can't afford a personal insolvency procedure because of the aforementioned reasons. Introduction of a cheaper and more effective system of administrative process of debt settlement through mediation or arbitration is recommended in Slovenia.

A final critical policy missing in Slovenia is a systematic assessment of the problem based on a definition on over-indebtedness and gathering of data on typologies of households that face the risk of high debt, as well as on types of financial services these households typically use. Without this data, debt advice cannot be tailored to the consumer needs, while timely market interventions to block provider practices that generate consumer defaults on credit repayment are impossible. Although ZPS has highlighted these problems for years, the government continues to ignore the need for a public policy to combat over-indebtedness.

[36] London Economics, Study on means to protect consumers in financial difficulty: Personal bankruptcy, datio in solutum of mortgages, and restrictions on debt collection abusive practices; 2012.

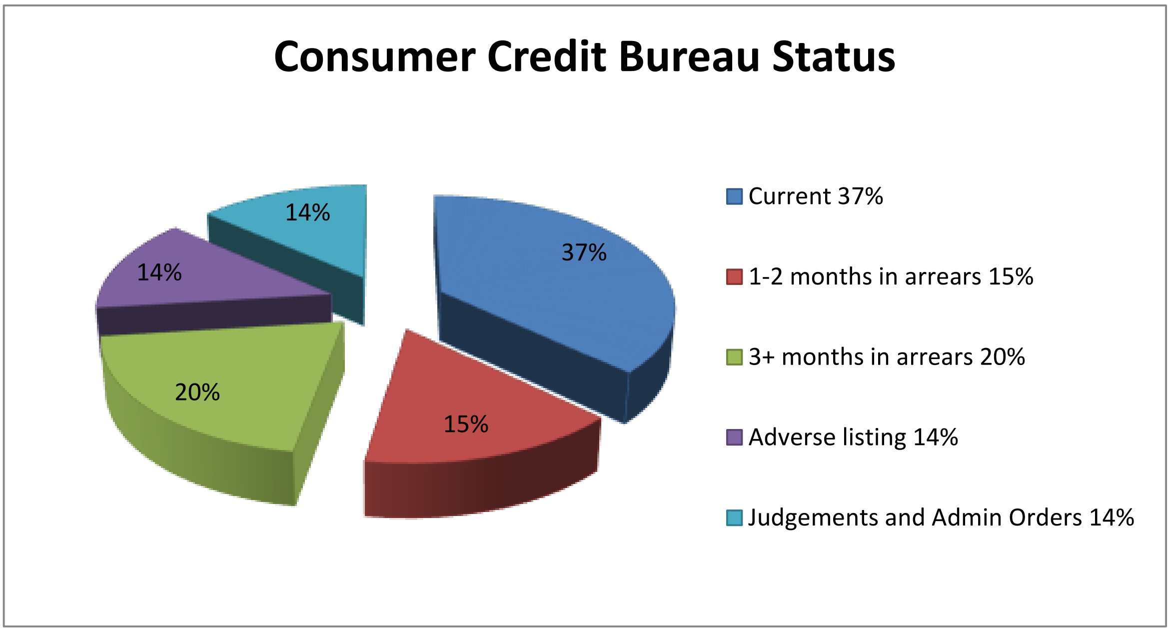
Chapter 11

Responsible lending policies and practices in South Africa

Magauta Mphahlele, Chief Executive Officer, National Debt Mediation Association

Overview of the consumer credit market

Statistics from Stats South Africa show that South Africa has a population of 51.8 million of which 40 million are between the ages of 15 and 64. This is the economically-active population. South Africa has an estimated unemployment rate of 25.6%. According to the National Credit Regulators (NCR) statistics, there are 20 million credit-active consumers in South Africa. This number reflects only those consumers who have credit agreements with formal institutions that are registered with the NCR. Of the 20 million credit-active consumers, slightly more than nine million have impaired credit records. The graph below illustrates the standing of consumers vis-à-vis their credit obligations.



According to the NCR, “the total outstanding gross debtor’s book of consumer credit for the quarter ended March 2013 was 1.45tn ZAR, representing a quarter on quarter growth of 0.57%. The number of accounts decreased by 0.92% for the same period. Mortgages accounted for 798.48bn ZAR (55.02%); ‘secured credit agreements’ for 295.04bn ZAR (20.33%); credit facilities for 171.44bn ZAR (11.81%); unsecured credit for 164.61bn ZAR (11.34%); short-term credit for 999.93m ZAR (0.07%); and developmental credit for 20.76bn ZAR (1.43%) of the total gross debtors book.

For the past few months various actors have expressed concerns regarding the growth in unsecured lending. While the Reserve Bank has indicated that this growth does not pose a systemic risk to the banking and financial system in South Africa, the NCR has expressed concerns about consumer protection issues, especially reckless lending, in response to which it published a set of affordability assessment guidelines to curb irresponsible or reckless lending.

Policy and regulation

In South Africa, the provision of credit is regulated by the National Credit Act of 2005 and secondary regulations published by the Minister of Trade and Industry. The act applies to all lenders including banks, micro lenders, clothing retailers, and furniture retailers. Every entity that provides credit must register with the National Credit Regulator. The exception is credit providers who have less than 100 agreements in their portfolio, or whose total outstanding credit agreements do not exceed 500,000. However, the requirement not to register does not exempt such entities from the application of the Act.

The enforcement of the Act is the responsibility of the National Credit Regulator, while the courts and the National Consumer Tribunal can adjudicate violations of the law depending on the type of transgression.

The aim of the Act was to reform the regulatory framework for credit, to protect consumers, create a fairer, more transparent and more competitive credit market by addressing the following market failures:

- Misleading and unfair marketing and selling practices;
- Credit providers unilaterally altering the terms of agreements;
- Unfair treatment of outstanding accounts and illegal debt enforcement procedures;
- Lack of transparency in the cost of credit;
- Excessive cost of credit;
- Over indebtedness and reckless lending;
- Lack of efficient dispute resolution and consumer redress; and
- Poor customer service.

Responsible lending

The NCA creates rights and responsibilities relating to the granting of credit. One of the rights provided for in the Act is the right of the consumer to apply for and receive credit, unless there are legitimate reasons why the credit cannot be granted. Consumers have a right to ask for reasons why credit has not been granted. Credit providers are required to ensure that the consumer can not only afford the credit but can also understand the costs and risks associated with credit. Consumers are required to be provided with a quote that is valid for five days to compare costs. The table below highlights the rights and obligations of each party.

Right	Credit Provider Requirements	Section
▪ Right to apply for credit but credit provider has right not to grant credit on *reasonable commercial grounds* that are customary with risk management and underwriting practices or in line with the requirements of the Act	Ensure that credit granting criteria in not unfairly discriminatory as per section 61.	60
▪ Protection against discrimination in credit granting; ▪ Scoring and evaluative mechanisms are also not to be unfairly discriminatory	Instances where discrimination is not allowed: ▪ Affordability assessment criteria ▪ Costing of credit ▪ Terms and conditions ▪ Enforcement procedures ▪ Reporting of credit information ▪ Risk evaluation and scoring mechanisms	61
▪ Right to be given reasons for credit being refused, or discontinued as outlined in section 62	▪ Written reasons for declining to enter into a credit agreement, refusing to increase a credit limit, refusing to renew a credit card or other facility	62
▪ Right to information in an official language	▪ Credit provider must make a submission to the NCR proposing two official languages in which it will produce any documents required in terms of the Act ▪ Provide language preference options to consumers	63
▪ Right to information in plain and understandable language	▪ Prescribed forms per category of agreement ▪ Plain language documents	64
▪ Right to receive documents	▪ Various mechanisms for delivery (fax, e-mail, printable web page, ordinary mail) at the written request of a consumer ▪ No cost to the consumer for first original copy	65
▪ Right to assert rights provided in terms of this Act	▪ Credit provider prohibited from penalizing, discriminate,	66

Responsible lending is addressed mainly through a combination of disclosure, price caps and reckless lending provisions. Section 48(1) also leaves the option open for some form of self-regulation by requiring industry to contribute to combating over-indebtedness through subscribing to a code approved by the NCR.

The reckless lending provisions of the NCA form the cornerstone of ensuring the responsible granting of credit. For any credit provider, the reckless lending requirements pose the biggest risk in view of the penalties that will be administered if there is a breach of these provisions. Penalties for reckless credit are severe and can lead to the suspension of an agreement determined to be reckless. Reckless lending can only be referred to court by a debt counsellor.

Section 82 allows the credit provider to develop its own evaluative mechanisms and models or procedures to enable it to conduct the assessment required above; as long as they are fair and objective. Credit providers may submit its mechanisms, models or procedures to the regulator for pre-approval. The National Consumer Tribunal (NCT), on the recommendation of the NCR, may impose mandatory guidelines on a credit provider who is consistently found to use evaluative mechanisms or procedures that are unfair and subjective.

Various reports issued by the NCR indicate that there has been a significant improvement in the application of affordability assessments. However, certain gaps in the legislation have created loopholes that are being exploited by some credit providers. Some of the challenges relate to enforcement and implementation such as:

- Not all credit providers apply robust and comprehensive evaluative mechanisms;
- Section 81(4) of the NCA nullifies the consumer's right to claim reckless lending if the credit provider can prove that the consumer failed to fully and truthfully answer any requests for information, and a court or the Tribunal determines that the consumer's failure to disclose materially affected the credit provider's ability to conduct a proper assessment;
- Not all debt is registered at the credit bureaux, and as such, the full picture of the consumer's exposure is not available;
- A register of credit agreements that was supposed to be developed and implemented by the NCR has not been developed; and
- The NCR only recently published affordability assessment guidelines, but these are currently not generally enforceable.

Objectivity in the assessment can only be achieved if all credit providers have access to credible and comprehensive information regarding the financial obligations of the consumer and there are prescribed standards for updating the bureaux as envisaged in section 69(2). This can only be achieved if comprehensive databases of credit and essential 'non-credit' obligations are available.

Objectivity can also be achieved if the playing fields are levelled where consumers are empowered with relevant information and advice to be able to conduct their own affordability assessments. For this to happen, consumers should have access to independent consumer education that is not linked to selling a product or increasing sales. Credit providers should focus on complying with the disclosure requirements of the NCA and other legislation, and leave consumer education to independent parties.

Evaluative mechanisms, models and procedures

In order to ensure compliance with the reckless lending provisions any credit provider must conduct a proper assessment of each consumer's ability to fully understand and meet their repayment obligations. The type of assessment required by section 81(2) places an obligation on the credit provider to fully assess:

- The consumers' general understanding of the risks and cost of the proposed credit;
- The rights and obligations of the consumer under the credit agreement;
- The debt repayment history of the consumer;
- Existing financial means, prospects and obligations; and
- Commercial prospects.

The Act does not prescribe any evaluative mechanisms, but requires them to be fair and objective and more importantly, that they do not unfairly discriminate against consumers.

Submission of consumer credit information to credit bureau

An evaluation of a consumer is not complete without comprehensive and up to date information from the credit bureau. To supplement credit bureau information, the NCR was supposed to establish the National Register of Credit Agreements, but this has not been done. This means that credit providers do not have access to the full exposure of the consumer.

The Department of Trade and Industry (DTI) and the NCR have made proposals in Parliament to implement a credit amnesty at the request of one of the houses of Parliament. The amnesty intends to remove certain consumer credit information from the credit bureaux in order to allow consumers to access credit. The credit industry is opposed to the proposed amnesty as they argue that it would prevent them from providing credit responsibly. Irrespective of industry opposition, the DTI has indicated that it aims to implement the amnesty by the beginning of 2014.

Cost of credit

The Act regulates the cost of credit by providing for the Minister to set an interest rate cap and other cost controls. Only the following charges, which must be disclosed upfront, are allowed:

- Principal debt;
- Prescribed initiation fee that can only be levied if an agreement is entered into;

- Prescribed service fee per transaction, monthly or annually;
- Prescribed interest rate;
- Credit insurance as per section 106;
- Prescribed default administration charges; and
- Prescribed collection costs.

Maximum prescribed interest rates

Sub Sector		Maximum Prescribed Interest Rate
Mortgage agreements		[(RRX2.2) + 5%] per annum
Credit facilities		[(RRX2.2) + 10%] per annum
Unsecured credit		[(RRX2.2) + 20%] per annum
Developmental credit agreements		
	For the development of a small business	[(RRX2.2) + 20%] per annum
	For low income housing (unsecured)	[(RRX2.2) + 20%] per annum
Short term credit transactions		5% per month
Other credit agreements		[(RRX2.2) + 10%] per annum
Incidental credit agreements		2% per month

RR = Reference rate as per the Reserve Bank repurchase rate which is currently 5%

Maximum initiation fees

The following must be noted with regards to initiation fees:

- An initiation fee may be charged for the transfer of a mortgage from one credit provider to another, where there is no transfer of ownership only if the consumer requested such a transfer;
- The levying of the fee and amount was disclosed to the consumer before they agreed to the transfer;
- No initiation fee may be charged for replacement agreements; and
- Initiation fees may never exceed 15% of the principal debt.

Sub Sector	Maximum Prescribed Interest Rate
Mortgage agreements	a) 1,000 ZAR per credit agreement plus 10% of the amount in excess of 10,000 ZAR b) But never to exceed R5000
Credit facilities	a) 150 ZAR per credit agreement plus 10% of the amount in excess of 1,000 ZAR b) But never to exceed 1,000 ZAR
Unsecured credit	a) 150 ZAR per credit agreement plus 10% of the amount in excess of 10,000 ZAR b) But never to exceed 1,000 ZAR

Penalties and offences for non-compliance by credit provider

The Act creates a dual system of enforcement where the tribunal has certain powers in relation to that of the courts. The courts have jurisdiction over offences while the tribunal has jurisdiction over prohibited conduct as defined in the Act.

Prohibited Conduct (Tribunal)	Offences and Contracts (Courts)
a) Confirming consent orders	a) Declaratory orders
b) Registrations	b) Suspension of reckless credit agreements
c) Compliance notices	c) Overcharging of interest rate and other fees
d) Unlawful advertising	d) Non-compliance with insurance charges
e) Unfair discrimination	e) Disputed accounts
f) Consumer rights	f) Surrender of goods
g) Failure to provide documents	g) Compensation awards for consumer or credit provider
h) Prohibited collection and enforcement practices	h) Restructuring of consumer's debt obligations
i) Payment processing practices	i) Enforcement of consent orders
	j) Debt enforcement

Only contraventions related to section 160(1) carry a fine or imprisonment of up to 10 years or both. Any other offence carries a fine or imprisonment of up to 12 months or both. In terms of section 151, the tribunal may impose an administrative fine that may not exceed the greater of:

- 10% of the respondent's annual turnover during the preceding financial year; or
- 1,000,000 ZAR

When determining the fine, the tribunal must consider:

- The nature, duration, gravity and extent of the contravention;
- Any loss or damage suffered as a result of the contravention;
- The behaviour of the respondent;
- The level of profit derived from the contravention;
- The degree of cooperation shown by the respondent; and
- Previous convictions.

In addition to administering fines, the tribunal can:

- Declare transactions or agreements unreasonable, unfair, unjust or unconscionable;
- Declare conduct prohibited i.t.o. the Act;
- Interdict prohibited conduct;
- Confirm consent orders;

- Condone non-compliance with its rules;
- Confirm an order to cease by the NCR; and
- Require supplier to:
    - Pay/repay money owed to a consumer;
    - Alter a practice that is inconsistent with the Act; and
    - Take reasonable steps to publicly acknowledge past contravention of the Act or abuse of consumer rights.

The decisions of the tribunal have the same status as that of the high courts and are binding on the NCR, provincial regulators, consumer courts, ADR agents, debt counsellor and the Magistrate's Court.

The NCR recently referred the African Bank, which is one of the biggest unsecured lenders to the tribunal, for alleged reckless lending and is asking for a fine of 300m ZAR. This is the first time the NCR is prosecuting reckless lending and observers are waiting to see how the tribunal deals with the matter, as the courts have jurisdiction to declare a specific credit agreement reckless.

The Banking Association of South Africa (BASA) and National Treasury also issued a joint statement in August 2012, committing the banks to adopting additional measures to curb reckless lending and promote responsible lending.

The Minister of Finance and the major retail banks and BASA have acknowledged that while there are currently no systemic risks related to unsecured (or secured) lending, certain market conduct behaviour may result in households, particularly poorer ones, getting caught in a debt spiral. In particular, BASA and the National Treasury:

- Note the importance of credit to the economy, particularly to grow small businesses, enable the purchase of houses and other assets, help students to study at higher-education institutions and so on.
- Agree with the September 2012 Financial Stability Review of the Reserve Bank that there are no financial stability risks at present, but accept the need to take steps to ensure that current lending trends do not increase future prudential risks.
- Recognise that although the efficient regulation of the banking sector limits the incidence of poor credit practices, some credit practices are undesirable and reckless, and agree on the need to deal with poor market conduct practices that contributes to over-indebtedness of borrowers.
- Support NCR in enforcing the law and stamping out poor market conduct practices, and encouraging it to improve preventative measures, including introducing stronger fit-and-proper criteria for all lenders.
- Agree that all financial service providers must be appropriately licensed or regulated, and that steps should be taken to improve supervision of credit bureaux and obligate all credit providers to update credit information at least once a week.
- Agree that perverse incentives favouring reckless lenders should be stopped.

- Agree that the payment system set minimum norms and standards for lenders to utilise the payment system.

To develop and implement the above agreement, various committees that have representation from all sectors of the credit industry have been set up and are working on a code for unsecured lending, affordability assessments, as well as consumer education strategies. It is understood that once the Treasury is happy with the proposed interventions, industry will implement these on a voluntary basis while complying with the law.

Policy reform

The DTI has recently published a draft policy review document and a draft amendment bill. With regards to responsible lending, the intention seems to render the affordability assessments binding, to make the updating of the credit bureau compulsory, extend the jurisdiction of the tribunal to adjudicate reckless lending cases and increase the power of the NCR to de-register credit providers without first approaching the tribunal.

The DTI has indicated that it is aiming for the first quarter of 2014 to pass the new amendment Bill.

The National Treasury has also published a policy document called the 'Twin Peaks' model of regulation. This policy document aims to establish a new market conduct regulator within the Financial Services Board and extend the jurisdiction of the prudential regulator, ie, the Reserve Bank, to other financial services providers. The introduction of "treating customers fairly" obligations is central to these reforms. Twin Peaks is expected to deliver more consumer protection, especially in the banking and broader financial services sector but the specific rules have not yet been defined.

Chapter 12

Responsible lending: The Uganda experience

Henry Richard Kimera, Consumer Education Trust

Consumer dilemma

Consumers in Uganda experience numerous challenges when accessing credit due to the wider macro-economic environment in which financial institutions operate, irrespective of existing policies and the legal and regulatory framework in place.

Individual consumers are victims of irresponsible lending due to limited knowledge regarding the norms and standard terms of credit, combined with the imbalance of power between the lender and borrower.

The high interest rates have variously been described as: “extortionist”, “fraudulent”, “theft”, “broad-day robbery”, among other emotion-laden adjectives. The credit market is also in an expansion mode, with various products, mainly targeting consumers who are largely excited about accessing credit to meet their consumption needs, but due to limited knowledge and ill-conceived implications regarding costs, this often results in consumer over-indebtedness, including the loss of property.

Consumers are faced with aggressive irresponsible marketing by some financial institutions and unregulated financial services that have led to over-indebtedness of the productive poor. Unfortunately, consumers are ill-equipped to confront the problems themselves. Further, the Ugandan market has been plagued with fraudulent pyramid schemes, which financially illiterate consumers continue to fall victim to, and which the government is failing to shut down.

The status quo requires the attention of a financial sector consumer protection policy as well as a legal and regulatory framework to deliver responsible lending to knowledgeable consumers. Further, this framework and a resultant pro active regulator would also address consumer concerns such as exploitative interest rates, misleading information, abusive collection practices, and debt traps by financial service providers.

Cost of borrowing

It is a fact that the cost of borrowing is high. Interest rates in Uganda range between 21 and 41% compared to the immediate East African region – Burundi, Kenya, Rwanda and Tanzania – where they are between 15 and 25% on average, and very high in comparison to the developed world.

The problem is also widespread in the informal sector, dominated by Savings and Credit Cooperative Associations (SACCO), Rotating Savings and Credit Association (ROSCAs), Microfinance Institutions (MFIs) and the completely unregulated loan sharks and money lenders.

The industry has maintained that they do not set interest rates, but market dynamics prescribe them. Government and industry regulators maintain a similar position. To consumers, the issue of high interest rates looks quite like a conspiracy in which the regulator is either ill-equipped to intervene or apathetic to the plight of the consumer.

The problem also adversely impacts small businesses in Uganda. Most businesses are formed as family enterprises and when accessing credit, they apply in their individual capacity. Businesses, like consumers, provide personal or family property as collateral to secure the credit facilities. This has caused significant harm to individuals and families when they are unable to repay and assets are seized, including homes.

In January 2012, the business community lead by Kampala City Traders' Association protested against a unilateral retroactive increase in interest rates as unfair both to businesses and consumers. The act was linked to monetary policies whereby the Bank of Uganda wanted to curb inflation through the central bank rate.

In protest, traders in Kampala, shutdown shops following the government's failure to positively intervene on the high interest rates charged by commercial banks on old loans.

Commercial banks increased their lending rates from an average of 17% in July 2011 to about 30% by January 2012. The chairperson of the Uganda Banker's Association responded to criticism by stating that the banks cannot reduce interest rates unless the central bank reduces the central bank rate. And, the Bank of Uganda's Governor, Emmanuel Tumusiime Mutebile, replied that the Central Bank could not reduce the Central Bank rate abruptly because the rate was curbing domestic inflation which was at 27%.

In short, everyone's hands were tied, but consumers and small businesses were still expected to pay these higher interest rates. (This scenario did not affect businesses alone but consumers too who borrowed and were thus affected by prevailing policy.)

This situation led to numerous small businesses closing.

All is not bleak in the financial markets, but vulnerable borrowers are exposed to potentially abusive lenders and they themselves do make poor borrowing decisions. Effective consumer awareness and education is one way to address the imbalance of power between lenders and borrowers facilitating more transparent pricing; less over-indebtedness; ending inappropriate collection practices, exploitive pricing, lack of confidence and breach of privacy issues regarding consumer data.

Interventions

Before the enactment of the Financial Institutions Statute (FIS) in 1993, major industry ills had been blamed on weak policy and weak legal and regulatory framework. With the dawn of new policy, legal and regulatory dispensation, namely the enactment and amendment of FIS in 2002 and the Bank of Uganda Act as well as the enactment of the Microfinance Deposit Taking Institutions and the Financial Institutions Act 2004, there were huge improvements registered.

Sector analysts observed that reduction in a number of failures borne out of ineffective regulation and supervision may have led to improvement in consumer confidence, but have not triggered considerable improvement in access to financial services. Where improvements have been visible, namely in retail banking, consumer concerns have emerged, underlining the possibility that customer care mechanisms or public relations initiatives, such as those instituted by industry players (like the Uganda Bankers Association (UBA) – Code of Good Banking Practice[37]) may not be effective, or were put in place but are not monitored for usefulness. Specifically, customer service remains an area of contention.

Therefore, the emergence of a financial sector (banking industry), characterised by a sufficiently strong capital base, profitability, effective management, good corporate governance, and well-designed systems and controls may be insufficient to effectively protect and serve consumers. If the aim, as has been the case, is to put in place a system that is contributing to the development of the economy, and improving the welfare of households, then the provider-consumer relationship should be better managed. Emphasis, many contend, should go beyond establishing the standard feedback channels, but addressing consumer concerns in the process in a timely and effective manner.

Implementation of effective financial consumer protection at all levels of the financial market will gradually manifest in responsible lending to consumers.

Consumer protection a central tenet

Consumer protection is customer service in its purest form, and it must become a central tenet of the financial institutions and market at all levels. The consumer protection framework should address:

- Consumer awareness. Consumers should be taught about financial products and services in detail before taking a decision. There must be access to simple, clear, complete and *understandable* information on products especially loans.
- Complaints handling. Consumers are sensitised on complaints' handling procedures, and timeframe for resolution.
- Transparent pricing. Consumers receive complete and *understandable* information about the true costs they are paying for loans and transaction services.
- Over-indebtedness. Consumers are not lent more than they can afford to repay without undue sacrifices.
- Inappropriate collection practices. Consumers are treated with dignity and are not deprived of their basic survival capacity as a result of loan repayment.

[37] UBA's Code of Good Banking Practice, www.ugandabankers.org

- Fair pricing. Consumers access fair rates fitting their portfolio. They have access to rates that are not exploitative leading to over-indebtedness.
- Privacy. Consumers' information is protected and not accessed and abused by authorised parties.

Empowered consumers deliver responsible lending

Consumer Education Trust (CONSENT) has engaged in the financial sector by conducting research[38], surveys[39], dialogues and lodging consumer concerns and complaints to financial institutions on behalf of consumers. This led to extensive engagement with the Bank of Uganda while developing the Financial Consumer Protection (FCP) Guidelines of 2011[40] for all supervised financial institutions (commercial banks, credit institutions and microfinance deposit-taking institutions, SFIs). CONSENT also joined the BoU Governor's committees namely: Financial Literacy Advisory Group, Financial Consumer Protection Consultative Group and Financial Literacy Information Sharing Group that have developed consumer rights, key facts documents on loans and savings plus multi-stakeholder financial literacy materials and strategies in preparation for the implementation and roll out of the FCP Guidelines and Literacy to Empower Consumers.

CONSENT recommends adoption and implementation of the FCP Guidelines[41] issued to promote consumer rights, fairness, transparency, reliability and proper handling of complaints in the financial institutions by:

- Establishing standards for financial services providers in dealing with consumers;
- Ensuring fair treatment of customers/consumers;
- Increasing transparency in order to inform and empower consumers of financial services; and
- Ensuring consumer complaints are handled promptly and fairly.

Acknowledgements
1. Mr. Shaban R. Sserunkuma, Programs Director, CONSENT
2. Bank of Uganda

[38] Competition and Consumer Protection Scenario in Uganda, 2003, by CUTS and CONSENT

[39] Consumer Perspective on Quality of Banking Services, November 2010, by CONSENT

[40] Bank of Uganda Financial Consumer Protection Guidelines, 2011, www.bou.or.ug

[41] Bank of Uganda Financial Consumer Protection Guidelines: Know Your Rights – www.bou.or.ug

Chapter 13

High-cost credit in the UK

Martin Saville, Principal Policy Adviser, Credit, Debt and Protection, Which?

At the end of 2012, outstanding consumer credit in the UK, excluding mortgages, stood at 157bn GBP, equivalent to approximately 3,000 GBP/adult. And yet, this total disguises a widely disparate consumer experience of credit, as many struggle with unmanageable, and often very expensive, debts.

While 22% of credit users in the 2012 Which? Credit Britain survey[42] had no unsecured debt at the time of the survey, a third owed up to 2,000 GBP and an additional quarter owed between 2,000 and 15,000 GBP. One in 10 credit-using households owed more than 15,000 GBP.

For many, it's unlikely to get any better in the near future. According to the Which? Consumer Insight tracker[43], nearly a third of consumers (31%) are still finding it difficult or very difficult to manage on their current household income. In July 2013, 28% dipped into savings to cover the month's spending, up from 21% in June. With existing savings being depleted, a growing number of people are turning to credit to pay for daily essentials like rent, food and utilities. Twenty-one percent have used an authorised overdraft facility in the last month; 14% have borrowed money from family or friends; 5% have used an unauthorised overdraft; and 4% have turned to a payday loan.

More worrying still, a quarter of payday loan users in the Credit Britain survey said they use the money to repay existing debt, as is the case with 19% of authorised overdraft users and 13% of those using an unauthorised overdraft. Strikingly, 55% of payday loan users in the survey had no savings at all, while a further 25% had less than 2,000 GBP.

Consumers have a responsibility to use credit sensibly, but the evidence Which? has gathered highlights a range of problems stacked against consumers. These problems are aggravated by lenders ready to exploit consumers' lack of alternatives, tagging on sky-high penalty fees and other irresponsible lending practices. There is an inherent imbalance of power between lenders and borrowers, combined with an ineffective regulator, which all leads to a perfect storm for consumers.

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[42] Populus, on behalf of Which?, surveyed 4,031 GB adults aged 18+ online (of which 3,195 were credit users) (Which? Credit Britain survey, August 2012). Results have been weighted to the profile of all GB adults. We followed up the survey with in-depth telephone interviews in December 2012 and January 2013.

[43] http://consumerinsight.which.co.uk/

Excessive penalty charges

Excessive penalty charges in the payday loan market unfairly exploit consumer behaviour. Consumers are often over-optimistic about their ability to repay, particularly when they are under financial pressure. While a third (29%) of payday loan users in the Credit Britain survey have taken out credit that they *knew they couldn't repay*, nearly half (48%) of payday loan users have taken out credit in the past that it *turned out* they couldn't afford to repay. Unauthorised overdraft users aren't far behind at 44%, followed by mail-order catalogue users at 29%.

The risk is greatest for high-cost credit, where default and arrears fees affect a large proportion of the total customer base. The survey found that one in five users of payday loans were hit by "unexpected" charges and that, in the last 12 months, more than half of payday loan users had incurred charges because of missed or bounced repayments.

The business model of some lenders appears to be based on the unsustainable default charges incurred by borrowers. When Which? examined payday loan companies' charges in June 2012, for example, it found charges of up to 30 GBP for failed payments. The UK credit regulator itself found one lender charging an average of 179 GBP in charges during the 35-day period following the repayment due date.

By applying excessive penalty fees to borrowers already in difficulty in order to *seemingly* reduce the advertised interest rate, while still maintaining high-profit margins, lenders manage to distort competition and cause consumers to underestimate the true cost of credit. Excessive charges also risk plunging some consumers who may already have squeezed budgets into a spiral of further debt.

Inappropriate marketing

Inappropriate marketing entices consumers to take on debt that may be inappropriate for their circumstances. In June 2012, Which? research found payday loan companies advertising loans for nights out, or inexplicably "to put in the bank for emergencies". One lender still advertises that a payday loan can help you to "solve all your money problems". Payday loan advertising also often prioritises speed of payment over cost. This can exploit the desperation of consumers unable to access mainstream credit.

Further, borrowers appear to have little control over what happens to their personal data. The 2012 Which? investigation found that four online lenders did not have any privacy policy, while others hid it away in the terms and conditions. In most cases, the sharing of data with third-party marketing firms was the default option, and not all let consumers opt out at the application stage. Some privacy policies stated that your details will be shared with third parties *even if* your application is unsuccessful. In a separate 2011 investigation, one Which? researcher received 47 unsolicited emails within a few days of taking out a loan.

Inappropriate loan rollovers

Payday loans are designed for short-term lending. However, many lenders' profit models are based on customers rolling over loans, and rollovers are marketed aggressively. In the 2011 Which? investigation, one researcher, after taking out a loan, was told "Need more time to pay back your loan? Don't worry, you still have five extensions available". (Upon rolling over a loan, the interest owed is incorporated into the principal, and the amount due continues to snowball.) For a customer in financial distress, rolling over a loan simply means delaying the point when they default or seek debt help. During the extended period of indebtedness their financial situation is likely to have further worsened due to interest charges.

Credit limit increases

Some lenders also offer inappropriate credit limit increases. One Which? researcher, having borrowed just 100 GBP, was then offered up to 1,200 GBP the next time he enquired about a loan. Two other researchers received letters from their lender stating "When you have paid back your outstanding loan, you will be eligible to borrow more – you are already pre-approved". This encourages inappropriate borrowing, often without appropriate affordability checks. As one consumer commented: ''It's too easy to get credit. If you make two payments on time they say, 'ok then you can have 500 more quid'". Another said: "It was so easy to get credit cards and loans and store cards. It was so easy to get it on the never. I will never get a credit card again, it's such a slippery road."

A failure to conduct full affordability assessments means consumers could take out more credit than they can afford to repay. The regulator's own investigation into the payday loan market found lenders failing to conduct adequate affordability assessments before lending or rolling over loans. In 2012's Which? investigation, eight of the 34 firms analysed did not conduct a credit check as part of their approval procedure. (They simply set up a continuous payment authority which allows them direct access to the customer's bank account or credit card.) An average charge for a payday loan is 25 GBP per 100 GBP borrowed per 30 days.

Solutions

The current regulator, the Office of Fair Trading (OFT), is underfunded and unable to regulate the consumer credit market efficiently. For example, according to the National Audit Office, the OFT received just 11.5m GBP in licence fees in 2011/12. In contrast, the total amount lent to consumers in that period was around 176bn GBP. This has led to an imbalance of power between lenders and borrowers.

Credit licences are issued indefinitely and there is only limited supervision and monitoring. Under the OFT regime, action only takes place in response to complaints or other intelligence about a lender. Of the 65,000 consumer credit licence holders in the UK, just 27 firms had their licence revoked in 2011/12.

The new UK regulator, the Financial Conduct Authority (FCA), takes over the regulation of consumer credit in April 2014 and has a bigger regulatory toolkit than the OFT. The FCA needs to be a strong, open and proactive regulator – a watchdog not a lapdog. Which? has set out five key challenges for the FCA to meet to clean up credit for consumers and to send a clear message to irresponsible lenders:

1. **Ban excessive default fees and charges**
The FCA should use its new powers to prevent lenders applying excessive charges by introducing a cap on the level, and total cost of default charges. The cap should be fair and reflect lenders' actual costs.

2. **Crack down on irresponsible lending**
Which? wants strong rules for affordability assessments on *all credit products*. Lenders must consider the borrower's income, expenditures and ability to repay the debt in a sustainable manner. This must include any outstanding credit commitments, particularly where credit is being taken out to repay existing debt.

3. **Put people in control of their credit**
The FCA can give more power to consumers by ending unsolicited increases in credit limits and requiring them to specifically request overdraft facilities. Further, a payday loan repayment should only be allowed to be rolled over once.

4. **Give consumers clear and transparent information**
The cost of credit as well as all fees and charges associated with the product should be clear. For high-cost credit it should be clearly displayed in GBPs per 100 GBP borrowed over 30 days. This would enable consumers to compare the cost of credit products at a glance. Credit products should also come with clear warnings, explaining the consequences of missed payments, and all costs and charges should be transparent.

5. **Swift and early intervention for people in financial difficulty**
The FCA should replicate the existing rules for mortgages for other credit products to help borrowers struggling with repayments. This should include limiting default charges, preventing lenders from charging interest on high-cost loans beyond 30 days; and requiring leaders to refer struggling borrowers to free independent debt advice, and there are some good free debt advice organisations in the UK, a list of which can be found on the Which? website at http://www.which.co.uk/debtadvice

Alternatives to payday

Just as payday loans are only part of the problem with consumer credit, cleaning up the payday sector is only a part of the solution. More affordable alternatives, such as credit unions, need to be developed. With many people using high-cost credit to pay for basics like rent and food, action is also needed to boost consumers' wider financial resilience.

The government recently invested 35m GBP in the UK credit union sector. With the current credit union interest rate cap of 26.8% set to rise to 42.6%, credit unions could soon compete profitably with payday loan and overdraft providers. Community Development Finance Institutions (CDFIs), social enterprises that provide affordable finance, could also play a role in this expansion of locally-based lending. There are currently around 400 credit unions and 60 CDFIs in the UK.[44]

However, there is a long way to go as these smaller players currently lack the infrastructure and advertising budgets of the big banks and payday lenders. Just one million people in the UK are currently members of their local credit union.[45] The public support of the Archbishop of Canterbury in July 2013 will undoubtedly help to raise awareness both through the Church of England opening its own credit union for church staff, and also by making church buildings available to local credit unions.

The UK government is also set to regulate the burgeoning peer-to-peer lending market, which could give consumers greater confidence and raise awareness of this lending alternative.

Conclusion

Lenders don't need to wait for the FCA to take on its new powers in April 2014. They can show they are responsible by acting now to put their own house in order. As one consumer said of lenders: "As long as they feel they will get the money back from you one way or another, they don't care at all about you as a person. I understand that a business is a business but I do think there should be more of a social and moral compass there."

With responsibility for regulating credit being transferred to the new FCA next year, there is a golden opportunity to bring rules up to date and end the practices that have pushed many consumers into a spiral of debt. The credit market needs a strong, open and proactive regulator. Consumers need a proper watchdog to clean up the credit market, not a lapdog to the lenders.

[44] http://www.cdfa.org.uk/about-cdfis/

[45] http://www.abcul.org/media-and-research/facts-statistics

Chapter 14

The US credit card reform ended many abusive industry practices but additional work remains

Christina Tetreault, Staff Attorney, Consumer Union

Introduction

In June 2008, Ronald lost his job. Money was tight, and he ended up paying his MasterCard bill a day late. Ronald had never previously missed a payment and had maintained a great credit history up to that point. Nevertheless, Chase hiked the interest rate on Ronald's MasterCard from 4.99 to 24.99%. A month later, Ronald paid his credit card bill online on the day it was due. Because it was after 4pm, Chase counted the payment as late and increased the interest rate another 5%.

Everything Chase did to Ronald was completely legal and consistent with standard credit card industry practice. At that time, credit card companies often included lines in their consumer contracts stating that they could change the terms of their agreements any time.[46] And they did. It was common practice to raise interest rates, change payment due dates, and abruptly lower credit limits. These practices often drove consumers even deeper into debt. When Ronald shared his credit card woes with Consumers Union (CU) in 2009, CU and other consumer groups in the United States were working to pass legislation that would end these abusive credit card industry tactics to ensure that what Chase did to Ronald was no longer legal.

Background: Consumer credit rate deregulation and the rise of consumer debt

Credit cards are a pay-later product. Each time a plastic credit card is swiped to make a purchase, the consumer is essentially taking out a loan to complete the transaction. Many early credit cards were marketed and used primarily as cash proxies.[47] In 1970, only about 6% of general purpose credit card users carried a balance. By 1995, however, more than one in three holders of general use cards such as MasterCard or Visa carried a balance from month to month.[48] The amount of that revolving debt continued to grow and by 2007, the average American carried 7,300 USD in credit card debt, an increase of more than 30% in

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[46] *See*, With Credit Cards, a Deal Is Not a Deal, Consumers Union Viewpoint (May 2008) http://www.consumerreports.org/cro/aboutus/mission/viewpoint/credit-card-pitfalls-5-08/overview/credit-card-rates-ov.htm (last visited August 8, 2013).

[47] Stuart Vyse, Going Broke: Why Americans Can't Hang Onto Their Money (2007) 98.

[48] Thomas A. Durkin, Federal Reserve Board, Division of Research and Statistics, Credit Cards: Use and Consumer Attitudes, 1970–2000 625, *available at* http://www.federalreserve.gov/pubs/bulletin/2000/0900lead.pdf.

just three years.[49] Lower income households were particularly strapped. Credit cards were often marketed as a means to the good life. Citibank advertised its cards with the tagline "Live Richly."[50] The reality was quite different. For some, credit cards served as a 'plastic safety net' to purchase necessities when income failed to cover basic living expenses.[51] By 2007, about one in three low- to middle-income households had credit card debt, and of those with incomes below 35,000 USD, the average credit card balance was 6,500 USD.[52] Consumers, rather than finding the good life by using credit cards, instead found themselves in a "cement life raft" of credit card debt.[53]

In the past, consumers with modest incomes would never have been able to rack-up unsecured debts equal to more than 20% of their income. So why, less than 50 years after the first general use credit cards came onto the market, did some consumers find themselves overwhelmed with credit card debt? A key element of increasing consumer debt was the deregulation of consumer interest rates.[54] In 1978, the United States Supreme Court, the highest court in the country, issued a decision, Marquette National Bank v First Omaha Service Corporation ("Marquette"). Marquette allowed national banks[55] to charge interest "on any loan" at the rate allowed by the laws of the state where the bank was "located".[56] So, Citibank – in exchange for promising to move a number of its high-paying jobs to the economically depressed state of South Dakota – convinced South Dakota's legislators to repeal the state's usury cap.[57] Citibank then moved its credit card operations to South Dakota. Once South Dakota was Citibank's "location", Citibank could charge consumers located anywhere in the US whatever interest rates it wanted. Today, most credit

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[49] Federal Reserve Bulletin, Changes in U.S. Family Finances from 2004 – 2007: Evidence from the Survey of Consumer Finances, February 2009 A45 *available at* http://www.federalreserve.gov/econresdata/scf/files/2007_bull09_SCF_nobkgdscreen.pdf

[50] Joseph Lamport, Wake Up and Smell the Subterfuge, http://www.salon.com/2002/02/04/bank_ads/

[51] Amy Traub and Catherine Ruetschlin, The Plastic Safety Net at 3, available at http://www.demos.org/sites/default/files/publications/PlasticSafetyNet-Demos.pdf.

[52] Tamara Draut, Debt: The New Safety Net, http://prospect.org/article/debt-new-safety-net.

[53] Elizabeth Warren and Amelia Warren Tyagi, Chapter Six, The Cement Life Raft from The Two Income Trap: Why Middle-Class Mothers and Fathers Are Going Broke, *available at* http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/cement.html.

[54] Discussion of the full range of reasons why American consumer debt exploded in the past decades is beyond the scope of this article. For those interested in that topic, *see* The Two Income Trap, supra note 6, for a discussion of how the rising price of housing (in particular) has increasingly driven middleclass families off the financial cliff. For those interest in a behavioral-finance discussion of mounting debt, *see* Stuart Vyse, Going Broke: Why Americans Can't Hang Onto Their Money (2007), supra note 3.

[55] National banks are banks chartered by and under the supervision of the Office of the Comptroller of the Currency.

[56] Marquette Nat. Bank v. First of Omaha Svc. Corp. 439 U.S. 299 at 308.
[57] Robin Stein, The Ascendency of the Credit Card Industry, PBS, The Secret History of the Credit Card, Frontline, http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html.

card lenders are headquartered in states with liberal usury ceilings and, like Citbank, "export" high rates to borrowers in other states, even if the states usury laws where the borrowers are residing would otherwise prohibit such high rates.[58]

Once it was legal to charge sky-high interest rates, credit card companies aggressively pursued new customers. At their 2005 peak, card companies mailed more than 6 billion credit card solicitations to Americans.[59] With no underwriting required by law, card companies freely lent to many who had no hope of ever paying off credit card debts completely.[60] Just before the financial crisis began, available credit card credit lines totaled about 5tn USD, 43,007 USD per American household.[61] College students and those making less than 30,000 USD/ year were frequent credit card company marketing targets. Between 1990 and 2005, consumer credit card debt went from 237bn USD to about 802bn USD — a 238% increase.[62] By 2008, Americans owed more than 950bn USD on their credit cards.[63] During roughly that same time, the amount owed by households earning 30,000 USD or less a year grew at a slightly faster pace, 247%.[64] College students soon carried heavy debt burdens, too. In 2008, the average college senior graduated with 4,100 USD in credit card debt.[65]

While some consumers failed to use credit cards responsibly, many were victims of injurious industry practices, such as retroactive interest rate hikes and abusive fees that drove their balances ever higher. Interest paid on credit cards accounts for the majority of industry revenues.[66] But starting in the 1990s, credit card companies increasingly relied on fee

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[58] Diane Ellis, The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate, FDIC Bank Trends, March 1998 Number 98-05, http://www.fdic.gov/bank/analytical/bank/bt_9805.html.

[59] Synovate Mail Monitor, http://mailmonitor.synovate.com/news.asp?txtDate=11/10/2008&txtTarYr=2008

[60] *See* James D. Scurlock, Maxed Out: Hard Times, Easy Credit, and the End of Predatory Lenders (2007).

[61] H.R. 5244, the Credit Cardholder's Bills of Rights: Providing New Protections for Consumers, Hearing Before the Subcommittee on Financial Institutions and Consumers Credit, House Committee on Financial Services, 110 Cong. 109, 226 (April 17, 2008) (testimony of Travis Plunkett, Consumer Federation of America), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_house_hearings&docid=f:42721.pdf.

[62] US Government Accountability Office, CREDIT CARDS: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers, September 2006, 88, *available at* http://www.gao.gov/new.items/d06929.pdf.

[63] GOVERNMENT ACCOUNTABILITY OFFICE, G19 FEDERAL RESERVE STATISTICAL RELEASE: CONSUMER CREDIT (2009), http://www.federalreserve.gov/releases/g19/Current/

[64] The Poverty Business, http://www.businessweek.com/stories/2007-05-20/the-poverty-business.

[65] SALLIE MAE, HOW UNDERGRADUATE STUDENTS USE CREDIT CARDS 3 (2009), http://www.salliemae.com/NR/rdonlyres/0BD600F1-9377-46EA-AB1F-6061FC763246/10744/SLMCreditCardUsageStudy41309FINAL2.pdf

[66] H.R. 5244, the Credit Cardholder's Bills of Rights: Providing New Protections for Consumers, Hearing Before the Subcommittee on Financial Institutions and Consumers Credit, House Committee on

income to drive credit card profits. Companies increased the number and the size of fees charged when cardholders paid late or exceeded their credit limits.[67] Of course, it was easy to miss the due date of a bill because credit card companies often moved the date around. In fact, by one estimate, about one-third of consumers paid a late fee in 2005.[68] By 2008, a significant portion of credit card revenues came from consumer fees.[69] By mid-2009, before credit card reforms took effect, credit card fee revenue alone topped 1.8bn USD/month.[70] At the time, there were no limits on fees or requirements about due dates, or bans on retroactive rate hikes. All of these practices were not addressed in the Truth in Lending Act (TILA), the 1968 federal law intended to ensure informed use of consumer credit, in its original form. Thus, reform was needed.

Fed-up consumers demand change and win

Consumers were fed-up with industry misdeeds and demanded change. Tens of thousands of consumers submitted their credit card horror stories to CU and other groups working for credit card reform. These stories were part of the lobbying efforts of CU, and were collected and posted on CU's now-defunct website, Creditcardreform.org. The site provided consumers with tips to avoid credit card industry traps, gave updates on proposed credit card legislation, and spurred consumers to take action by contacting legislators to support credit card reform. After many false starts, these efforts were eventually successful.

The United States Congress passed landmark legislation that outlawed the most egregious credit card industry practices: The Credit Card Accountability Responsibility and Disclosure (CARD) Act.[71] Signed into law on 22 May 2009, the CARD Act amended the Truth in Lending Act (TILA), and ended many of the 'tricks and traps' that kept consumers mired in credit card

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Financial Services, 110 Cong. 100, 157 (Mar. 13, 2008) (testimony of Prof. Elizabeth Warren), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_house_hearings&docid=f:41731.pdf.

[67] United States Government Accountability Office Report to the Ranking Minority Member, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate, CREDIT CARDS: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers (September 2006) 13, available at http://www.gao.gov/new.items/d06929.pdf.

[68] Id.

[69] H.R. 5244, the Credit Cardholder's Bills of Rights: Providing New Protections for Consumers, Hearing Before the Subcommittee on Financial Institutions and Consumers Credit, House Committee on Financial Services, 110 Cong. 100, 157 (Mar. 13, 2008) (testimony of Prof. Elizabeth Warren), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_house_hearings&docid=f:41731.pdf.

[70] Teresa Dixon Murray, Three years after credit card reform, consumers save millions but, in some cases, see fewer rewards and more fees, February 14, 2013, http://www.cleveland.com/business/index.ssf/2013/02/three_years_after_credit_card.html.

[71] Public Law 111–24.

debt. CARD Act reforms include[72] limits on repricing and fees, improved underwriting, sensible due dates, protections for young consumers, and improved disclosures:

Limits on re-pricing

- Bans credit card issuers from raising interest rates in the first year after a credit card account is opened (though there are a few exceptions).
- Prohibits increases on the interest rate charged to *existing balances* unless the increase is under a variable interest rate, is at the end of a promotional rate, or if the required minimum payment is not received within 60 days after the due date.

Limits on fees

- Establishes that penalty fees must be "reasonable and proportional" to the omission or violation.

Improved underwriting

- Requires issuers to consider consumers' ability to make the required payments before raising limits or issuing a new card.

Sensible due dates and time to pay

- Due dates will be on the same day each month.
- Prohibits issuers from treating payments as late unless the bill is mailed or delivered at least 21 days before payment is due.

Protections for young consumers

- Requires either a co-signer older than 21 or information indicating an independent means of repaying before any credit extended.
- Bans increases to the credit limit on accounts of people younger than 21 without co-signer written permission.
- Ends prescreened credit card offers to people younger than 21 without consumer consent; and restricts marketing of credit cards on college campuses.

Improved disclosures

- Establishes a particular format for disclosures.
- Requires the inclusion of the time it will take and the total amount of interest that will be paid if only the minimum monthly payments are made.

These sensible CARD Act reforms ended some of the most egregious credit card practices and empowered consumers to better mange their use of credit.[73]

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[72] Included here are only partial descriptions of CARD Act reforms; for the complete CARD Act law, *see* http://www.gpo.gov/fdsys/pkg/PLAW-111publ24/pdf/PLAW-111publ24.pdf.

[73] CONSUMER FINANCIAL PROTECTION BUREAU, CARD ACT CONFERENCE: KEY FINDINGS, http://www.consumerfinance.gov/credit-cards/credit-card-act/card-act-conference-key-findings/.

CARD Act success and remaining work

A number of studies show that the CARD Act has made credit cards safer[74] and more transparent[75] without increasing the cost[76] or availability of credit. For example, improved disclosures mandated by the CARD Act are providing greater transparency to the cost of credit. Credit card statements now come with better disclosures to show consumers how much more money they'll spend and how long it will take to pay off a bill by making just the minimum payment. In fact, a July 2010 *Consumer Reports®* survey found that as a result, 23% of consumers surveyed are now paying more than the minimum payment because they understand how much it can save in interest.[77] At least one study shows that this trend has continued.[78] Of course, disclosures alone are not enough to enable consumers to defend themselves against complicated credit card practices.

Despite progress in protecting consumers from abusive industry practices, work remains to be done. Consumers continue to encounter trouble with credit card companies' practices. The Consumer Financial Protection Bureau (CFPB), the federal governmental oragnisation established to protect consumers in the financial marketplace,[79] collects consumer complaints about financial products and services. Between 21 July 2011 and 30 September 2012, consumers logged a total 23,400 complaints about credit cards.[80] It also has taken enforcement action against credit card companies. In 2012, the CFPB fined Capital One and Discover for deceptive practices related to credit card add-ons, and went after American Express for a variety of violations including deceptive marketing and unlawful late fees.[81] In

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[74] PEW HEALTH GROUP, TWO STEPS FORWARD, AFTER THE CREDIT CARD ACT, CREDIT CARDS ARE SAFER AND MORE TRANSPARENT – BUT CHALLENGES REMAIN (2010), *available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Credit_Cards/PEW-CreditCard%20FINAL.PDF.

[75] JOSHUA. M. FRANK, CREDIT CARD CLARITY: CARD ACT REFORM WORKS (2011), *available at* http://www.responsiblelending.org/credit-cards/research-analysis/credit-card-clarity.html.

[76] Felix Solomon, *Don't Blame Regulation for Your Credit Card Bill*, REUTERS.COM, Jan. 14, 2013, http://blogs.reuters.com/felix-salmon/2013/01/14/dont-blame-regulation-for-your-credit-card-bill/.

[77] Press Release, Consumers Union, CARD Act Has Provided Significant Protections For Credit Card Consumers During Its First Year; Consumer Financial Protection Bureau Should Address Lingering Credit Card Abuses (Feb. 17, 2011), on file with Consumers Union.

[78] AMY TRAUB & CATHERINE RUETSCHLIN, THE PLASTIC SAFETY NET: FINDINGS FROM THE 2012 NATIONAL SURVEY ON CREDIT CARD DEBT OF LOW - AND MIDDLE INCOME HOUSEHOLDS, 20 (2012), *available at* http://www.demos.org/sites/default/files/publications/PlasticSafetyNet-Demos.pdf.

[79] Public Law No: 111-203, Title X, available at http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm.

[80] The Consumer Financial Protection Bureau, Consumer Response:
A Snapshot of Complaints Received, page 4, Oct. 10, 2012, *available at*
http://files.consumerfinance.gov/f/201210_cfpb_consumer_response_september-30-snapshot.pdf

[81] *See also*, Regulators Hit AmEx with $112M Enforcement Action, Joe Adler and Kate Davidson, Oct. 1, 2012, http://www.americanbanker.com/issues/177_190/regulators-hit-american-express-with-112-million-enforcement-action-1053145-1.html

the near future, the CFPB is expected to continue this important industry monitoring, supervision and intervention in the credit card industry.

Conclusion

American consumers' credit card debt had reached unmanageable levels by 2009. Some consumer misery was created by abusive credit card industry practices, such as punitive fees and penalty rates. Existing law did not address these issues, and reform was needed. The landmark 2009 federal law, the CARD Act, was instrumental in ending many of the worst credit card industry practices. Consumers are subject to fewer credit card fees and are less likely to be tricked by credit card industry traps. However, gaps remain. Some credit card companies have continued to behave in ways destructive to consumer financial health. Reforms have improved but not eliminated problems in the credit card market, and continued vigilance by the CFPB and consumer advocates is essential.

Chapter 15

Alleviating the student loan burden: How a few simple fixes could help consumers

Suzanne Martindale, Staff Attorney, Consumer Union

The US student loan market

Americans now owe more than 1tn USD in student loan debt, surpassing even credit card debt.[i] The American government is the largest student lender, with roughly 85% of the market, but banks and financial companies also offer student loans.[ii] The Department of Education is projected to earn 51bn USD in profit this year from student loans.[iii]

Business is booming for lenders, but that isn't exactly a good thing for the millions of families struggling to keep up with the cost of education. Tuition has increased more than 500% since 1985 at public colleges, which admit the vast majority of students nationwide.[iv] Average family incomes (adjusted for inflation) are lower than they were a decade ago, making it even harder to pay for college without loans.[v]

Currently, two-thirds of American college students graduate with student loan debt.[vi] Those borrowers owe an average of 26,600 USD.[vii] Student debt isn't just a problem for 18-22 year olds: two-thirds of student loan borrowers are older than 30, and 15% are older than 50.[viii] It is almost impossible to walk away from a student loan: borrowers who default may be subject to aggressive collection tactics for years.[ix] The federal government can garnish wages and even Social Security pensions without going to court.[x] Meanwhile, student loans are nearly impossible to discharge in bankruptcy, unlike credit card or even gambling debts.[xi]

The long-term effects are hard to predict, but some experts worry that student debt could be a significant obstacle to improvements in the housing market, and to the nation's economic recovery as a whole, because borrowers must delay other life-cycle investments like cars and homes in order to afford their student loan payments.[xii] It is also alarming that student loan debt has grown since the 2008 financial crisis, while all other forms of consumer debt have shrunk.[xiii]

Where borrowers need more help

There are two decisive moments that affect the student loan borrower's financial health. The first occurs when the borrower is deciding where to enroll in school and how to pay for it and the second is when the borrower must begin repayment.

When deciding where to go to college, students and families often receive inadequate financial aid information and counselling. Comparing the costs of different colleges is an important part of deciding where to enroll. However, financial aid letters do not have a standard format. It can be difficult to compare offers, because some schools don't clarify which financing options are true ‘financial aid’, such as grants, and which options are actually loans.[xiv]

The federal government only requires students to complete one-time ‘entrance counselling’, consisting of answering questions online after already committing to taking out government loans.[xv] Many borrowers don’t understand the terms of their loans, and are surprised about the size of their monthly payments after graduation.[xvi]

When beginning repayment, borrowers may have trouble accessing suitable repayment plans. Borrowers with government loans have options under federal law: they can choose ‘income-based’ plans that adjust monthly payments based on current income and provide longer repayment periods.[xvii] Borrowers can also suspend payments in times of unemployment or other hardship, in many cases without accruing more interest while those payments are deferred.[xviii] However, many borrowers receive inadequate information about how to exercise these options.[xix] Furthermore, borrowers who don’t affirmatively request an alternative plan are automatically enrolled in a 10-year repayment plan, which may set higher monthly payments than the borrower can afford.[xx]

Many borrowers also take out private loans, without knowing that they qualify for government loans.[xxi] Borrowers with private loans have limited rights. They don’t have the guaranteed right to choose flexible repayment plans or to defer their payments in case of hardship. In addition, while government loans have fixed interest rates, many private loans come with high, variable interest rates, making them costlier to repay.[xxii] However, because financial aid offers typically fail to explain these distinctions, borrowers may not appreciate the differences between government and private loans until the loans become due.

Furthermore, even after borrowers make timely payments and their finances improve, they can’t refinance their loans and get lower interest rates. Government loans have fixed rates with no refinance options, and at present there is little to no market for private loan refinancing.[xxiii] In a new report on private student loan complaint data, the Consumer Financial Protection Bureau (CFPB) found that borrowers’ problems modifying or lowering monthly payments topped the list of complaints.[xxiv]

What has been done, and what needs to be done

As part of the 2010 Dodd-Frank Act, the CFPB has jurisdiction over private student loans, which have been lightly regulated to date.[xxv] As one of its first actions on student loan issues, the CFPB partnered with the Department of Education to create model forms that clearly explain different financing options, as well as estimate students’ monthly loan payments after graduation.[xxvi] The agency also developed an interactive online tool that helps students compare financial aid offers.[xxvii]

At present, the CFPB is exploring possible initiatives to help make private loans more affordable, including the creation of a credit facility or other government-financed capital resource mechanism to spur a refinance market.[xxviii] In addition, the agency has plans to examine the practices of student loan servicers, which interact directly with borrowers to process payments and handle other aspects of the loans on behalf of lenders.[xxix] These recent actions suggest that the CFPB will focus its next efforts on ensuring that borrowers with existing debts have fairer and more flexible options for staying current on their student loans.

In another promising development, three other banking agencies recently issued a joint statement encouraging banks to restructure private student loans and better educate borrowers about their options.[xxx]

However, these efforts are insufficient – policymakers must take action now. In the short term, three changes would immediately aid borrowers applying for loans, and those preparing to repay their loans:

- **Require standardised, plain-language financial aid forms.** All schools should be required to use the model developed by the CFPB and the Department of Education. This will help students make more informed choices, even if some schools lack resources for adequate counselling.
- **Provide flexible repayment plans for all loans.** Improve access to income-based plans for government loans, and make interest-free deferments available for students experiencing financial stress. Private lenders should also be required to work with borrowers to ensure monthly payments are affordable, and should restructure loans when appropriate.
- **Facilitate a refinance market for student loans.** Borrowers making timely payments should be able to qualify for lower interest rates. All options for jump-starting a refinance market, including public-private partnerships, should be explored.

Consumers Union's seven principles for fair student lending

Consumers Union (CU) believes that all students deserve affordable access to quality higher education. Until education costs decrease, students and families will need access to student loans. To that end, CU has developed the following agenda for comprehensive reform of the student loan system:

- **Transparency: Lending options should be easily comparable**

Schools should be required to provide standardised, plain-language forms that clearly explain students' options for financing education, including grants and scholarships as well as loans. The disclosures should explain the differences between private and federal loans, and calculate estimated monthly loan payments after graduation.

- **Borrowing options: Schools should help students find the most affordable loans**

To prevent unnecessary borrowing, private lenders should be required to check with the borrower's school before making a loan. Schools should provide students with pre-loan counselling to review loan costs and eligibility requirements for less costly options.

- **Flexible repayment: Borrowers must be given reasonable options**

Lenders should offer flexible and affordable repayment options, including income-based payment plans, deferments and forbearances, regardless of the type of loan. Lenders should also permit refinancing, and accept partial payments.

- **Reasonable costs: Fees should be reasonable and proportional to services provided**

Borrowers should not be penalised with excessive, new or hidden fees. Lenders should not be allowed to manipulate payments in a manner that harms borrowers.

- **Accountability: Students should have access to effective and timely loan inquiries and dispute resolution**

Those who administer and collect student loan payments should be required to establish clear procedures and a single point of contact for questions and complaints. Complaints handling, resolution and appeals should be centralised and monitored by regulators.

- **Fairness: Abusive, unfair or fraudulent practices must not be permitted**

All borrowers should be protected from deceptive marketing, abusive collection and repayment practices, identity theft, school kickbacks and other fraudulent practices.

- **Reasonable relief: Loans shouldn’t be a lifelong burden**

All borrowers should receive opportunities to rehabilitate loans back into good standing with affordable and sustainable repayment plans. Borrowers should also have the opportunity to obtain loan repayment deferrals and cancellations in certain circumstances, including long-term economic hardship.

[i] Josh Mitchell & Maya Jackson-Randall, *Student-Loan Debt Tops $1 Trillion*, WALL ST. J., Mar. 22, 2012, *available at* http://online.wsj.com/article/SB10001424052702303812904577295930047604846.html?mod=ITP_pageone_1 (citing new estimate by Consumer Financial Protection Bureau).

[ii] Rohit Chopra, Consumer Fin. Protection Bureau, Student Loans Swell, Federal Loans Now Top a Trillion, Address Before the Ctr. for American Progress (July 17, 2013), *available at* http://www.consumerfinance.gov/speeches/student-debt-swells-federal-loans-now-top-a-trillion/.

[iii] Congressional Budget Office, CBO May 2013 Baseline Projections for the Student Loan Program, *available at* http://www.cbo.gov/sites/default/files/cbofiles/attachments/44198_StudentLoanPrograms.pdf.

[iv] Catherine Rampell, *Why Tuition Has Skyrocketed at State Schools*, N.Y. TIMES, Mar. 2, 2012, *available at* http://economix.blogs.nytimes.com/2012/03/02/why-tuition-has-skyrocketed-at-state-schools/ (citing figures from the Bureau of Labor Statistics).

[v] College Board, Trends in Higher Education, Trends in College Pricing, Changes in Family Income Over Time, http://trends.collegeboard.org/college-pricing/figures-tables/changes-family-income-over-time (last visited Feb. 12, 2013).

[vi] THE INST. FOR COLLEGE ACCESS & SUCCESS, STUDENT DEBT AND THE CLASS OF 2011 1 (2012), *available at* http://projectonstudentdebt.org/files/pub/classof2011.pdf.

[vii] *Id.*

[viii] *Id.* (summarising data used in CAMPUS PROGRESS, THE STUDENT DEBT CRISIS 20 (2012), *available at* http://www.americanprogress.org/wp-content/uploads/2012/10/WhiteStudentDebt-5.pdf).

[ix] For example, the federal government has the power to garnish wages – and even protected benefits like Social Security – without needing a court order. *See* NAT'L CONSUMER LAW CTR., STUDENT LOAN BORROWER ASSISTANCE PROJECT, NO WAY OUT: STUDENT LOANS, FINANCIAL DISTRESS, AND THE NEED FOR POLICY REFORM 6 (2006), *available at* http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/nowayout.pdf.

[x] 31 C.F.R. §§ 900-904 (2011) (setting standards for government collection of all "federal claims," including student loan debts).

[xi] Student loans can only be discharged if the debtor can show that repaying the debt will "impose an undue hardship on the debtor and the debtor's dependents." 11 U.S.C. § 523(a)(8) (2006 & Supp. V).

[xii] *See* NAT'L ASS'N OF CONSUMER BANKRUPTCY ATTORNEYS, THE STUDENT LOAN "DEBT BOMB": AMERICA'S NEXT MORTGAGE-STYLE ECONOMIC CRISIS? 2 (2012), *available at* http://nacba.org/Portals/0/Documents/Student%20Loan%20Debt/020712%20NACBA%20student%20loan%20debt%20report.pdf (warning of negative impact high debt burdens can have on financial decisions such as home-buying and saving fore retirement).

[xiii] DONGHOON LEE, FED. RES. BANK OF N.Y., HOUSEHOLD CREDIT & DEBT: STUDENT DEBT 5 (2013), *available at* http://www.newyorkfed.org/newsevents/mediaadvisory/2013/Lee022813.pdf (PowerPoint presentation highlighting 2012:Q4 data specific to student loans).

[xiv] Janet Lorin, *Colleges Confuse Students with Letters Offering Aid That's Debt*, BLOOMBERG NEWS, Apr. 23, 2012, *available at* http://www.bloomberg.com/news/2012-04-24/colleges-confuse-students-with-letters-offering-aid-that-s-debt.html.

[xv] THE INST. FOR COLLEGE ACCESS & SUCCESS, ALIGNING THE MEANS AND THE ENDS: HOW TO IMPROVE FEDREAL STUDENT AID AND INCREASE COLLEGE ACCESS AND SUCCESS 64 (2013), *available at* http://projectonstudentdebt.org/files/pub/TICAS_RADD_White_Paper.pdf.

[xvi] *See* YOUNG INVINCIBLES, HIGH DEBT, LOW INFORMATION: A SURVEY OF STUDENT LOAN BORROWERS 2 (2012), *available at* http://www.younginvincibles.org/News/Releases/PUB_Student_Loan_Borrowers_FINAL.pdf (finding that 65% of respondents misunderstood loan terms; two-thirds did not understand difference between federal and private loans; and 20% were surprised by loan payment amounts).

[xvii] College Cost Reduction and Access Act of 2007, Pub. L. No. 110-84, 121 Stat. 784 (2007).

[xviii] 20 U.S.C. § 1087e(f) (2012).

[xix] THE INST. FOR COLLEGE ACCESS & SUCCESS, *supra* note xv, at 63.

[xx] For more information on the IBR plan, *see* U.S. Dep't of Education, Student Aid on the Web, Income-Based Repayment Plan, http://studentaid.ed.gov/PORTALSWebApp/students/english/IBRPlan.jsp.

[xxi] THE INST. FOR COLLEGE ACCESS & SUCCESS, CRITICAL CHOICES: HOW COLLEGES CAN HELP STUDENTS AND FAMILIES MAKE BETTER DECISIONS ABOUT PRIVATE LOANS 4 (2011), *available at* http://ticas.org/files/pub/critical_choices.pdf.

[xxii] *See, e.g.*, Student Loan Analytics, Private Loan Options, http://studentlendinganalytics.com/alternative_loan_options.html (last updated Sept. 14, 2011).

[xxiii] Request for Information Regarding Initiative to Promote Student Loan Affordability, 78 Fed. Reg. 13327, 13328 (Feb. 27, 2013).

[xxiv] CONSUMER FIN. PROTECTION BUREAU, MID-YEAR SNAPSHOT OF PRIVATE STUDENT LOAN COMPLAINTS 5 (2013), *available at* http://files.consumerfinance.gov/f/201308_cfpb_complaint-snapshot.pdf.

[xxv] Pub. L. No. 111-203, 124 Stat. 1376, 1987 (2010).

[xxvi] Consumer Fin. Protection Bureau, Know Before You Owe (Student Loans), http://www.consumerfinance.gov/students/knowbeforeyouowe/.

[xxvii] Consumer Fin. Protection Bureau, Paying For College, http://www.consumerfinance.gov/paying-for-college/.

[xxviii] CONSUMER FIN. PROTECTION BUREAU, STUDENT LOAN AFFORDABILITY: ANALYSIS OF PUBLIC INPUT ON IMPACT AND SOLUTIONS 24 (2013), *available at* http://files.consumerfinance.gov/f/201305_cfpb_rfi-report_student-loans.pdf; *see also* Consumers Union, Letter to Consumer Fin. Protection Bureau (Apr. 5, 2013), *available at* http://defendyourdollars.org/wordpress/wp-content/uploads/2013/04/CFPB_comment_private_-loans_4_13.pdf.

[xxix] Defining Larger Participants of the Student Loan Servicing Market, 78 Fed. Reg. 18902 (Mar. 28, 2013).

[xxx] Press Release, Fed. Reserve Bd., Fed. Deposit Ins. Corp., & Office of the Comptroller of Currency, Banks Encourage Financial Institutions to Work with Student Loan Borrowers Experiencing Financial Difficulties (July 25, 2013), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20130725a1.pdf.