Citizens Advice Scotland

Scottish Association of Citizens Advice Bureaux

Consumer Credit and Personal Insolvency Landscape: Call for Evidence

A response from Citizens Advice Scotland

Citizens Advice Scotland and its 81 CAB offices form Scotland's largest independent advice network. CAB advice services are delivered through more than 200 service points throughout Scotland, from the islands to city centres. The CAB service aims: to ensure that individuals do not suffer through lack of knowledge of their rights and responsibilities, or of the services available to them, or through an inability to express their need effectively and equally to exercise a responsible influence on the development of social policies and services, both locally and nationally. The CAB service is independent and provides free, confidential and impartial advice to everybody regardless of race, sex, disability or sexuality.

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The Scottish Association of Citizens Advice Bureaux - Citizens Advice Scotland (Scottish charity number SC016637)

Introduction

1. Citizens Advice Scotland (CAS) and its CAB offices form Scotland's largest independent advice network. Citizens Advice Scotland (CAS) is the umbrella organisation for Scotland’s network of over 80 Citizens Advice Bureau (CAB) offices. These bureaux deliver frontline advice services throughout nearly 200 service points across the country, from the city centres of Glasgow and Edinburgh to the Highlands, Islands and rural Borders communities.

2. There are 2,200 volunteers in the service who provide almost 13,000 hours of their time each and every week. Paid staff provide a further 15,200 hours of work each week in management, support, administration and specialist advice work.

3. There are citizens advice bureaux in 30 of the 32 local authorities in Scotland, making the network the only independent advice body in the country with truly national on the ground coverage.

4. An Ipsos Mori poll in 2009 found that one in five people in Scotland had visited a bureau for advice in the last three years.

5. CAS welcomes the opportunity to respond to the Department of Business, Innovation and Skill’s call for evidence on the consumer credit and personal insolvency landscape.

6. In 2009/10, bureaux across Scotland dealt with 545,715 new issues, including 135,032 debt issues and 17,848 issues relating to financial products and services. Over 2,000 of the new issues relating to financial products and services were with secured and unsecured loans. 1,112 were regarding credit reference agencies, more than 700 related to store and credit cards, and 336 were on debt management and credit repair.

7. Store and credit card debt and unsecured personal loan debt are the two biggest issues brought to bureaux in Scotland. Other consumer debt problems dealt with by bureaux include 11,294 bank overdraft issues, 6,949 catalogue debt issues, and 4,603 fuel debt issues.

8. Policies and legislation relating to debt remedies is devolved in Scotland and consequently the responsibility of the Scottish administration. Last year bureaux dealt with 15,810 new issues relating to clients seeking assistance with debt remedies, of which three out of ten were related to the Low Income Low Asset (LILA) route to bankruptcy and one in ten concerned the Debt Arrangement Scheme (DAS).

9. This response is based on client evidence received from bureaux in Scotland and will discuss issues, policies and practices surrounding credit products, credit and store cards, bank overdrafts and charging policies, credit scoring, and debt remedies in Scotland.

Advertisement

Q1. Should the Government extend regulations on advertising for credit products beyond the cost of credit?

Q2. Should consumer credit advertising rules be aligned with those which the FSA applies to secured credit?

1. Citizens Advice Scotland's (CAS) response[1] to OFT's Consumer Credit Review highlighted the issues with credit advertisements, particularly those broadcast on television. Client evidence received from bureaux in Scotland shows that credit advertisements are partial and fail to alert the consumer to potential costs associated with and that result from credit agreements and the difficulties that may arise.

> A South of Scotland CAB reports of a client who took out a loan of £25,100 from a finance company having seen their TV advertisement. The client was impressed with the advert's claims that the loan would be fair and easy to process. The bureau found that the repayments will be £294.51 per month over a period of 300 months. The actual sum to be repaid on the £25,100 loan is £88,353.
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> An East of Scotland CAB reports of a young client with a mental health condition who responded to an advert offering a guaranteed loan of £10,000. The client paid a fee of £49.95 and was offered a loan of £3,300 at an interest rate of forty five per cent. The client feels that the advert was misleading and inaccurate.

2. CAS agrees that consumer credit advertising rules should be aligned with those of the FSA. All advertising for credit products should be clear, accurate and balanced.

[1] CAS, *Consumer Credit Review*, 2009; p3

Cooling off period

Q3. What would be the impact of a 7-day cooling off period for store cards on (a) consumer behaviour

3. The principle of a seven day cooling off period for store cards is welcome. We would like to know how this would work with the new provision in the Consumer Credit Directive for ‘withdrawal within 14 days’. We assume that the ‘cooling off period’ and ‘withdrawal period’ are two provisions that complement each other; where a cooling off period does not allow for a card to be used for the seven days, the 14 day withdrawal period allows credit to be taken out while giving the right for the credit agreement to be ended by consumers without explanation within the allotted time period. It is important that store and credit companies provide clear and concise information on the terms and conditions associated with the credit contract, including associated costs, at the point of sale.

4. Evidence from CAB across Scotland shows that some clients are inappropriately given large amounts of unsecured credit, putting those who already carry store card and credit card debts at risk of further indebtedness.

> An East of Scotland CAB reports of an elderly client on a pension and who works part time. The client and her husband live in their daughter’s house and have 12 credit and store card debts, catalogue debts and bank loans.
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> A North of Scotland CAB reports of a client who owes over £30,000 on credit card, store cards and in overdraft charges.
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> A South of Scotland CAB reports of a client who has £14,000 of credit and store card debts.

5. Bureaux have dealt with clients who have money to pay for their purchases and have been encouraged to take out a store card and buy on credit instead. The short term incentive can lead to financial difficulty for clients who are vulnerable, particularly those who have little experience with the credit market and are unaware of the conditions associated with non payment. A cooling off period where clients cannot use credit for the first seven days and can cancel any agreements accordingly would help avoid situations where clients have taken the incentive only to have to pay off debt that they did not want or need in the first place.

> An East of Scotland CAB reports of a client who suffers from anxiety, depression and is in receipt of benefit payments. The client states that he was persuaded to take out a store credit card for a purchase that he had money to pay for. The client had never before had any sort of credit card and states that he was advised he would not have to pay until the bill came in. The client has now received a bill for over £180 for a £25 purchase – it appears that part of the bill is for an identity protection product associated with the card.

6. Some clients are unable to understand the consequences of having an interest rate applied to their outstanding balance and may have a short term debt that has become unsustainable due to loss of employment, relationship breakdown, sickness or a decrease in income in general. Clear and concise information should be provided by credit companies, including store card providers on the application of interest charges on an outstanding balance prior to any credit agreement being signed.

> A North of Scotland CAB reports of a client who has a personal loan of over £2,000 and states that she can’t understand the way interest is applied to her loan as it appears very high.
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> A North of Scotland CAB reports of a client who suffers from anxiety and depression and has debt on a store card. The client has been unable to make regular payments on the card as she is currently receiving JobSeekers Allowance. The debt is continuing to build due to the interest & default charges added and the client has little money left to live on.
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> A West of Scotland CAB reports of a client who has an overdraft and two credit cards with his bank. The client approached the bank for a loan to pay off one of his credit cards to enable him to rationalise his debts and was looking to repay the loan over 4 years. The client’s application was refused and instead he was offered an increase in his overdraft to £2000. The client accepted the agreement and paid off one of his credit cards. However, the bank has since added arrangement charges which have put him over his new overdraft limit and further charges have been added as a result. Since the agreement the client has incurred £200 of charges and £71 in interest. The bank are seeking immediate payment for his debt.
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> A West of Scotland CAB reports of an elderly client who was encouraged by a credit card company representative to take out a credit card. The client withdrew £20 on the card unaware of the high interest associated with the transaction and is now experiencing difficulty in paying off the card because of the interest rates and charges incurred. The current balance on the card is over £200. The client’s current monthly payments of £15 seem only to cover her interest payments.
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> A North of Scotland CAB reports of a client who took out a £2500 loan from a bank 4 years ago. Even though the client has been mostly making regular payments towards the loan she has most recently been advised that her balance owing is £14,000. The client does not understand how this could happen and feels that she was deceived by the creditor.

7. A seven day cooling off period must come with checks on the clarity and unambiguity of information provided by credit companies prior to an agreement being entered into.

OFT recommendations

Q4. We would in particular welcome your views on the following OFT recommendations:

8. CAS welcomes the OFT's High Cost Credit Review. The Review outlines the high cost that low income consumers must pay for access to often essential credit. The Review also shows that access to this form of credit should not be closed off to consumers, but rather that improvements must be made to the market to ensure that access, affordability, and consumer understanding are all improved.

9. CAS, however, considers the Review's scope to be too narrow. While many creditors on the fringes of the consumer credit market offer credit at extremely high interest rates, it must also be noted that interest and charges levied by most mainstream lenders can make their credit just as expensive.

10. While a number of credit agreements start as affordable and low cost credit (ie. the interest rate is relatively low), they can quickly turn into very expensive credit when interest and charges are actually added on. While subprime credit is expensive at the outset, their policies on arrears can actually be relatively favourable to a client. Mainstream creditors, on the other hand, can add interest and charges to a client in arrears that can suddenly make credit agreements much more expensive than expected. We would therefore argue that the interest and charges that mainstream creditors impose on clients in arrears should be considered as high cost credit.

11. CAS's response to the recommendations of the OFT Review:

That the Government works with lenders to provide information on high-cost credit loans to consumers through price comparison websites

12. CAS welcomes this recommendation. It is important that consumers have full knowledge of the terms and costs of credit before they sign any agreement. However, while the annual interest rate is the most general way of distinguishing the cost of credit, it should be made clear that additional costs may make credit more expensive. It may be the case that unexpected costs, such as penalties for missing payments or early payment fees, actually make credit much more expensive than the annual interest rate would have suggested. Information provided to consumers on the credit agreement needs to reflect this.

That the Government works with credit reference agencies to explore ways in which payday lenders and rent-to-buy suppliers could provide suitable information to credit reference agencies about the payment performance of

their customers, in turn allowing those with good payment records to use mainstream lenders more easily in the future.

13. CAS welcomes this recommendation. Allowing low income consumers the opportunity of building a good credit history through responsible use of credit will help improve access to mainstream (and hopefully affordable) lending. This action will also allow consumers to access credit with better terms and conditions.

That the OFT collects essential information on the high-cost credit sector, such as the volume, value and pricing of credit, levels of repeat business and defaults among customers as needed. This will help OFT understand the effects of its recommendations and provide better evidence for future policy making.

14. Appropriate monitoring is essential to better understand both the sector and the effects of the recommendations. It would be a positive step for the OFT to collect this information so that they can question any costs that they believe to be unreasonable. This would improve the information that is passed on to consumers.

15. It is, however, important to bear in mind that defaulting on high cost doorstep lending may be difficult to monitor as the interest and added costs are front-loaded and so there are no default charges per se. While these debtors are not continuously incurring extra costs – at the end of the process they are often unable to afford this sort of credit.

That the relevant trade associations for home credit suppliers, payday lenders and pawnbrokers establish a code or codes of practice covering best practice policy including on: complaints and advice to customers, policies on rolling over of loans, limits for amounts to lend to consumers, avoiding misleading consumers through advertisements and ensuring that consumers are aware of the ultimate owners of brand names.

16. Most high credit providers are members of either the Consumer Credit Association or the Consumer Credit Trade Association. Complaints can be made through either local Trading Standards or to the Financial Ombudsman. We would welcome working with these Trade Associations to share any concerns and to work towards a code of practice. We also recommend a code of practice from the Office of Fair Trading who can then take immediate action against companies that fail to comply.

Data sharing and credit scoring

Q5. Is there a need for greater sharing of data between the consumer credit industry and other bodies, including utility companies, local authorities and HMRC?

17. Greater data sharing would ensure that there is more affordable and responsible lending by creditors who should then be able to refer consumers to debt advice services if necessary. It would be beneficial if current creditors use these data sharing resources to help consumers who are going through periods of financial instability.

> A South of Scotland CAB reports of a client who is a single parent. The client works part time and is struggling to keep her debts in check. She has a car loan, a bank overdraft and a credit card debt. The client's bank's new policy of charging a fixed amount per day on any overdraft has significantly increased the client's repayments and has made it harder for her to clear her debts.
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> A West of Scotland CAB reports of a client whose partner lost his job. The client is working and earning £800.00 per month which means that her partner does not qualify for any benefits. The client has a mortgage and a secured loan against their house and is finding it difficult to make the payments. They also have other unsecured debt. The client and her partner are currently not in any arrears. The client is trying to receive help from her payment protection plan and contacted the CAB for money advice relating to the debts.

Q6. It has also been suggested that there needs to be greater transparency around credit scoring and the impact of credit scores on charges. Do you agree?

18. Current credit score reports are not people friendly and in order for consumers to understand the impact of the credit they take out in their name they need to know how any financial issues or mistakes can affect their credit rating. Any changes applied to the credit score report must ensure that the information made available to consumers is clear, transparent and well explained. The application of interest rates based on credit rating needs to be explained to consumers using plain English.

> A South of Scotland CAB reports of an elderly client who has two credit cards, one from 50 years ago and the other for 42 years. The client who pays off her balance at the end of every month reports that recently due to an oversight she made her payments two weeks late. The client has since received letters from her credit card company advising her that the credit limit on one of the credit cards had been cut from £5000 to £450 and on the other card from £3,500 to £260. The client is confused by this information and upon contact with her local bureau got a copy of her credit report. The client is unable to see anything negative in the report and on contact with her credit card

provider was advised that she should take up any issues with the credit reference agency and not the credit provider.

Response to stakeholder proposals

Q7. Which of these stakeholder proposals do you consider would bring benefits to industry or consumers and what would these be? Please provide evidence in support of your view.

Decision to borrow::

19. **Statement 1**. CAS sees no reason to amend the areas of automatic unenforceability. Where a regulated agreement has not been signed or did not contain a prescribed term or the applicable cancellation notices they are unenforceable if they came into effect before 6 April 2007. This protects the consumer where they had an improperly executed agreement prior to this date without the stress of having to attend court.

20. **Statement 2.** It is important that consumer protection is maintained - if more agreements are to be concluded on line then it is important that clients can be seen to have been given the same protection as if they had signed a paper agreement.

21. **Statement 3.** Section 18 requires that two parts of the loan be regarded as separate loans if they are already separate categories of agreement. This in turn requires that the prescribed terms for each part must be listed on the agreement: loan amount, regular repayments and APR for both must be listed separately. CAS believes that to maintain consumer protection this must not change.

22. **Statement 4**.The Consumer Credit Directive brings in a 14 day period in which to withdraw from the credit agreement without any reason having to be given. CAS recommends that this new right is applied to all agreements.

23. **Statement 5.** It would be helpful if all statements for people who have entered into a trust deed could be forwarded to their trustee. There are clearly issues if statements are delivered to an address where the client no longer resides - the creditor should make reasonable enquiries to find the whereabouts of the debtor.

24. **Statement 6.** It will be the decision of the courts as to whether there has been an unfair relationship and therefore the client has been disadvantaged. If the agreement is deemed unenforceable by the court then the client has been disadvantaged.

25. **Statement 7.** Sections 99 and 100 give appropriate control to the debtor to terminate an agreement for a reasonable figure and should remain unchanged.

26. **Statement 8.** Section 185 – this is dependent on the policies to be recommended and the agreement between the account holders and the creditor/bank.

What happens when things go wrong:

27. **<u>Statement 1</u>.** It is absolutely essential that banks are able to identify and help customers who are in financial difficulty. However, in too many cases, banks put their customers into greater financial difficulty by failing to recognise a customer in difficulty and continuing to add interest and charges to a burgeoning debt. In many cases seen by bureaux, this can happen even when the client has informed the bank of their financial difficulties.

28. Where customers fall behind on repayments, the response of the bank can put the customer into further difficulty, including offering further credit, changing overdraft limits, refusing new offers of repayment, and sometimes cutting off access to banking facilities altogether.

A North of Scotland CAB reports of a client who had her account closed by her bank after offering a reduced repayment for her debts. The client is a pensioner whose main source of income is her state pension. The client was having difficulty meeting the repayments on the loan and the bureau made a reduced offer of repayment to the bank and sent the bank a copy of her financial statement. The bank immediately closed her bank account with the result that her state pension which was due on that day seems to be lost. The bank was very unhelpful and would not return calls. The bank eventually offered to open a new account and to try to trace the £380 which had disappeared.

A West of Scotland CAB reports of a client who received unsympathetic treatment from her bank when repaying her loan. The client has a repayment arrangement in place with her bank that was due to be reviewed in October. The client received a worrying phone call from the bank saying that there is no way that the present arrangement will continue after October and offered a final settlement figure of £9,000 for a debt of around £11,000. They suggested if she did not take advantage of this offer "her house would be involved".

29. Banks often fail to identify customers for whom overdraft charges are placing them in severe financial difficulty. Bureaux see clients on a regular basis who have incurred hundreds of pounds of charges for a relatively small initial overdraft.

30. Where banks do react to snowballing charges, their actions can further severely disadvantage the client, including through the closing a client’s account, taking away a client’s overdraft facility, and refusing offers of repayment.

An East of Scotland CAB reports of a client who had her agreed bank overdraft removed after sending the bank a letter requesting repayment of bank charges she felt were unfair. Upon receiving the letter, the bank removed her agreed overdraft, leaving her liable to charges once again, and gave the client a week to repay the overdraft (£600). The bureau felt that the bank's actions were retaliatory, and advised the client to report the matter to the Financial Ombudsman.

A West of Scotland CAB reports of client who built up a £900 overdraft after being made redundant. The client is keen to repay his overdraft, but his bank is insisting on monthly payments of £138 when the client only receives £160 a month in benefit payments. In the meantime, interest and charges continue to mount on the client's overdraft, while the client's JSA payments are being 'swallowed up' by the bank leaving the client with nothing to live on. The client is relying completely on his mother for money and support.

An East of Scotland CAB reports of a client whose account was frozen after he sought advice on clearing his overdraft. The client had financial problems that had pushed his account over his authorised overdraft limit. The client sought advice from the bureau to help him stay out of overdraft and avoid charges. The bureau wrote to the bank asking them to consider reimbursing some of the charges to help stabilise his position while he worked out repayments to the bank and his creditors. The bank responded by freezing the client's account, leaving the client with no access to funds, even though he was within his authorised overdraft at that time. The bureau requested an explanation and was told that the account had been frozen as the accounts were "at risk". The client feels he is being punished for trying to be responsible with his money and repay his debts.

31. These cases, and many others, show the imperative need for banks to identify and take appropriate action to help those in financial difficulty. As customers continue to struggle from the effects of the recession and as we enter into a period of public sector redundancies, it is essential that banks are able to identify and offer early help to those who are struggling financially.

32. **Statement 2.** Overdraft debt continues to be a huge problem for bureau clients, with bureau helping with over 11,000 overdraft debt issues in 2009/10. Many of these issues begin with a relatively small overdraft debt which quickly balloons into a large debt through disproportionate interest and charges. The provision of emergency borrowing facilities would help avoid many of these cases. However, while this idea has been taken on in a limited form by some banks, many clients continue to struggle to access limited facilities that would significantly improve their financial situation.

A South of Scotland CAB reports of a client whose bank refused to allow him a small overdraft facility even though the client was slightly in debt at the end of each month. The client requested an overdraft facility of £100 as the client was incurring hefty bank charges at the end of each month after small incursions into his overdraft. The charges meant that the client would struggle to stay out of his overdraft the following month, thereby ensuring that the client was stuck in a cycle of debt. The client was eventually forced to apply for bankruptcy due to this situation and other mounting debts.

33. Banks could provide a small buffer zone in a customer's overdraft in which they have a certain number of days to clear their debt before they incur charges. This system would ensure that clients aren't hit with high charges for very small infringements into their overdraft, and allows for extra leeway for affording cheques and direct debit payments.

34. An alternative remedy would be to allow customers to have three chances at staying out of their overdraft before they incur charges. This would allow customers to learn from their mistakes, rather than being put into unserviceable debt the first time they enter their overdraft.

35. **Statements 3-8** CAS welcomes initiatives for greater monitoring of credit license holders particularly as a number of debt clients have found themselves in an unsustainable financial situation due to irresponsible lending.

    Some clients keep receiving unsolicited credit cards even when they already owe money on others and/or where they are unable to meet payments on existing credit cards. Others find it easy to qualify for cards knowing little about the terms and conditions of the credit agreement. This can put clients in a position where they spend money they do not have, with little means to make adequate repayments leading to money mismanagement and over indebtedness.

> A South of Scotland CAB reports of a client who keeps receiving credit cards in the mail and is looking to stop these being issued in the first place. The client is receiving credit cards from the company she already has credit card debts with.
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> Client interview from Drowning in Debt[2]:
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> *"I had thirty-odd credit cards. They kept sending me application forms so I just filled them in and sent them back. Some of them gave wee incentives as well. Like with one of them, I got a mobile phone out of it… (Bank), it was £14000 or £15000 limits on them. I had five of them."*

36. CAS recommends that credit companies be monitored for the pre-contractual information provided to clients, their sales practices, responsible lending practices, and debt assistance.

37. **Statement 9.** Credit with high interest rates can actually sometimes prove less expensive than low cost credit agreements due to less favourable charges on arrears.

38. A bank's policy on overdraft charges can also mean that excessive and disproportionate charges are added to a relatively small debt. It is not inconceivable that a client could slip into their overdraft unknowingly by a few pounds, miss two direct debits, and buy three items while over the limit. The

[2] Citizens Advice Scotland, *Drowning in Debt: Scottish CAB Clients and Debt,* June 2009, p38

result of this situation would be a set of multiple charges – and another set of charges if the client cannot afford the original charges.

39. This is an example of a ‘snowball’ effect, in which a client enters their overdraft on one occasion and incurs multiple charges. This effect can cause severe detriment to clients and condemn them to an endless cycle of charges. The impact of overdraft charges is explored in greater detail under Question 8 in this response.

40. CAS supports the principle of limiting the ability of creditors to add excessive interest and charges to arrears or overdraft debt. This is particularly the case for banks who too often allow multiple charges to compound the problems experienced by customers in financial difficulty. Creditors need to be better at identifying customers in financial difficulty, respond sympathetically and appropriately to customers who approach them for help, freeze charges and interest where it is clear that the customer does not have the ability to repay them, and work with customers to agree solutions to debt problems rather than compounding them.

Bank Overdrafts

Q8: Do you believe that the current voluntary, market-driven initiatives to address concerns about unarranged overdraft charges are delivering, or will deliver, sufficient improvements for consumers? If not, what would the wider implications of limited bank charges be? Please provide evidence in support of your views:

41. CAS does not believe that current market-driven initiatives are sufficient to address concerns about unarranged overdraft charges. Revenue from overdraft charges makes up a significant proportion of retail revenue for UK banks. It is not in the interests of the banks to see this revenue fall and it is therefore unlikely that voluntary initiatives will see a significant improvement in policy and practice. We therefore believe that it is essential that the Coalition Government take action to meet their commitment to end unfair bank and financial transaction charges.

42. The overdraft charges problem has existed for a number of years and is a situation that has not improved for customers despite the high profile test case brought by the OFT. It was hoped that the Supreme Court case regarding overdraft charges would help resolve the issue, but while the decision in favour of the banks may have brought clarity for bankers, it ensures that unclear and unfair overdraft charges continue to adversely affect millions of people.

<u>Impact of bank charges on clients</u>

43. Overdraft charges remain unfair and disproportionate, and are a significant problem for low income clients. This system of charges inherently discriminates against low income customers, where the level of charges is insensitive to the level of infringement. Many of these clients are in a vulnerable situation, such as having a low income, suffering from health problems, being a lone parent, or being a single pensioner.

> An East of Scotland CAB reports of a client who incurred excessive bank charges for a small overdraft. The client is a mature student who works part-time. The client went 60 pence into his overdraft and was charged £28 and a subsequent charge of £38. Since then, the client has been unable to clear his overdraft. The client only earns £50 per week, and finds himself in an impossible situation.
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> A West of Scotland CAB reports of a disabled lone parent who was given an overdraft charge after exceeding her overdraft limit for one day. The client stated that she regularly checks the status of her account using the telephone services and was at no time made aware of a problem with her account. The client feels that the £28 charge is excessive and unfair.

A North of Scotland CAB reports of a client who received over £60 of charges after spending £9 in a shop. The client cannot understand why the charges are so high for a very small overdraft, and is very upset at effectively losing a full week's income.

An East of Scotland CAB reports of a client who was charged nearly £100 for an unauthorised overdraft of £7.30. The client complained to the bank about the high charges for a small overdraft, but is yet to receive a response.

A West of Scotland CAB reports of a client who received £75 in bank charges for a £17 overdraft, despite crediting her account with £20 on the same day as she went into overdraft.

An East of Scotland CAB reports of a client who received £47 of bank charges for an overdraft of 47 pence. The client phoned the bank to complain, but was told that if the charge was not paid she would be charged double next month.

A South of Scotland CAB reports of a pensioner who incurred overdraft charges of over £1,000 in an eight month period. In one month alone, the client received over £550 in charges – the client only receives £600 a month through his occupational pension.

44. The variety of different types of overdraft and similar charges – insufficient funds charges, missed payment charges, and item charges, among others - mean that clients can receive levels of charges that are massively disproportionate to the level of infringement. It is not inconceivable that a client could slip into their overdraft unknowingly by a few pounds, miss two direct debits, and buy three items while over the limit.

45. In many ways, overdraft charges are effectively a form of short term high cost lending. For example, a client who goes into their overdraft by £2 for any reason will incur charges that they may not be able to afford. The upshot of this is that they continue to incur charges and the amount that the client pays for the initial 'borrowing' of £2 continues to accrue.

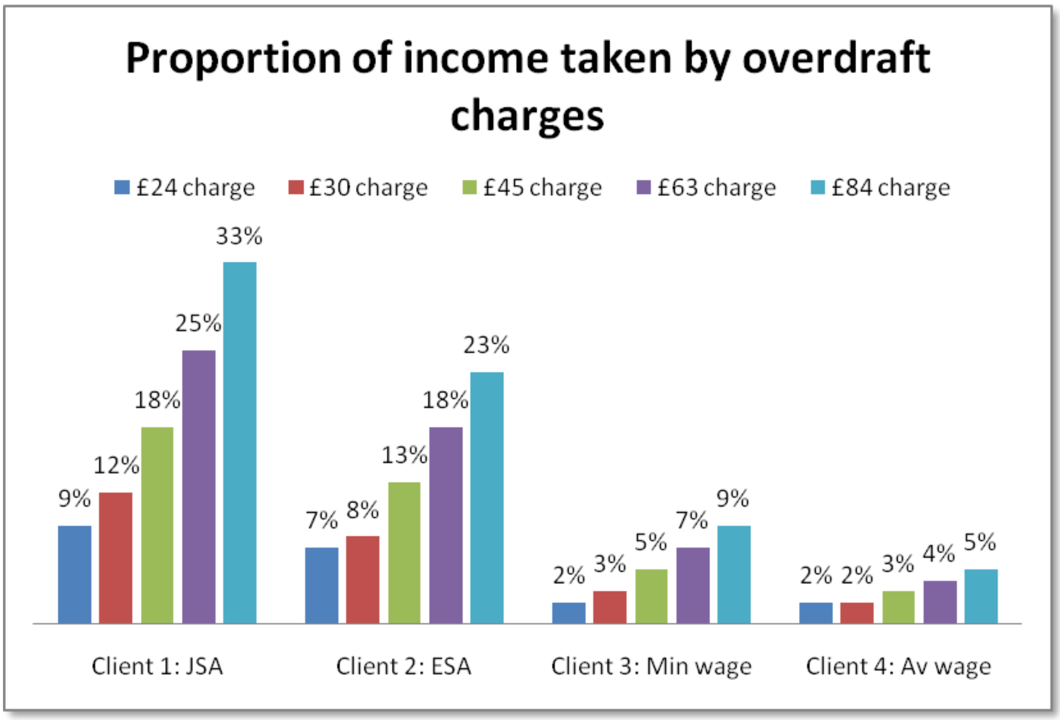
46. The upshot of the variety of charges that clients can incur has resulted in a substantial cross subsidisation from those who incur charges and those who do not. According to the OFT market study, and supported by our evidence, this cross subsidisation is from low income, low saving clients, to high income, higher saving consumers. Indeed, the revenue made from the customers who incur charges is actually keeping the cost of an account low for other higher income customers.[3]

Disproportionate impact

47. CAS published the *Fully Charged* report in June 2010, which showed the disproportionate impact that overdraft charges have on clients with different

[3] Personal Current Accounts in the UK July 2008 - http://www.oft.gov.uk/news/press/2008/84-08

circumstances. The following figure shows the impact of the same charges on four different clients: one who has been made redundant and is claiming JSA, one who is unable to work due to illness and recieves ESA, a client in full-time employment on the minimum wage, and a client receiving an average full-time wage:



48. The figure shows that clients receiving JSA pay a proportion of their income that is six times higher than the average worker for the same charges – this means that **the impact of bank charges is six times worse when a client loses their job**. For many people struggling in the recession, this statistic is a reality and not merely theoretical.

Response from the banks

49. A number of banks have responded to widespread criticism of their overdraft charges through new policies. Work has been undertaken in conjunction with the OFT to ensure that all charges are transparent for customers. However, for those in financial difficulty, a better understanding of charges is unlikely to help them avoid such charges if they simply can't afford to.

50. At least two banks have implemented a daily charge for exceeding overdraft limits of around £5. This policy may be of benefit for customers who accidentally exceed their limit for one day, but for many customers in severe financial difficulty or on a low income this type of policy can be catastrophic. For example, a client who exceeds their limit, but does not have enough income to clear the overdraft immediately, could face charges of over £150 in

a month. This can lead to an unsustainable cycle of debt for what may have been a small level of overdraft.

A North of Scotland CAB reports of a client who is being charged £5 a day for being in her unauthorised overdraft. The client is unemployed and her only income is Jobseekers Allowance (JSA) at £64 per week. The client has an overdraft of £150 and is being charged £5 a day until she pays this amount. The client can neither afford to pay off the total amount nor the £5 per day. More than half of the client's income is taken up by bank charges.

51. Following the judgement in favour of the banks at the Supreme Court in November 2009, the UK banks have been less receptive to customer concerns regarding overdraft charges, with a number of banks dismissing customer complaints. This has been a double whammy for customers – as the recession puts many into financial difficulty, their banks are free to continue imposing high charges on them to add to their difficulties.

A West of Scotland CAB reports of a client who has two bank accounts. One of the accounts was overdrawn by a small amount, incurring bank charges and the client now owes the bank £2,150. The client had challenged these charges and had an agreement with the bank to pay £20 a month towards the debt. However, since the Supreme Court's ruling on bank charges in favour of the banks the client has been told by her bank to pay off the full amount owed. The bank is closing both her accounts with them. The client feels that she is being victimized for challenging the charges.

52. CAS considers the policy responses from the UK banks to be ineffectual in solving the problem of unfair and disproportionate overdraft charges. With the threat of OFT legal challenge lifted, there is little incentive for banks to make changes to a system that has made them considerable revenue in recent years, despite the obvious detriment it causes to millions of customers.

53. It is therefore imperative that the Government honours its commitment to end unfair bank charges. In our *Fully Charged* report CAS outlined a number of remedies that banks should consider to improve their policies and practices:

- **Greater discretion in applying charges** - taking into account a debtor's financial situation, such as other debts or benefit-only income, before automatically applying charges
- **Proportional charging** – charging clients on a scale according to how much they owe on their overdraft. Those in their overdraft by small amounts should receive small charges
- **Helping clients repay their overdraft debts** - overdraft charges and interest should be frozen when it becomes clear that the client does not have the ability to repay them – allowing the customer a chance of repaying them

- **Opt-in overdrafts** – giving customers the option of not going into their overdraft when they have run out of funds
- **Warning systems** – warning clients, through mobile phone messages, when they are close to or into their overdrafts and giving a time period to repay
- **Buffer zones** – allowing a small amount that customers can use to go into their overdraft in which they can repay without charges within a time limit

54. These remedies would go some way to ensuring that banks impose charges that are fair and more proportionate to a client's situation. It would also decrease the level of charges and number of customers incurring these charges, thereby giving vulnerable customers greater opportunity to control their finances and get back in the black.

Interest rates

Q9. Should interest rates on credit and store cards be subject to a cap? If so, should this apply to all interest rates or only those which apply to existing borrowing?

Q10. Are there any alternative measures which would reduce the scope for consumers to be exposed to higher interest rates on credit and store cards?

55. Scottish CAB clients who are vulnerable are more likely to be using sub-prime credit cards which already carry higher interest rates[4]. A re-evaluation of interest rates may end up leaving vulnerable clients financially worse off as it may increase the inaccessibility of affordable mainstream credit available to them.

56. A number of clients have been disadvantaged by the re-pricing of their credit. This is extremely harmful for clients who were always able to meet their monthly payments and suddenly find themselves, under the changed agreement, to be unable to do so.

> A West of Scotland CAB reports of a client who owes £9000 on his credit card and has met all his minimum monthly payments. The client's credit card company have now doubled his interest rate and are threatening to sell the debt. The client is worried that it will take longer to pay off his debt than previously anticipated.

57. As many low income clients are unable to gain access to affordable interest rates, consideration should be given to introducing a basic credit product with an affordable interest rate that serves low income or vulnerable clients seeking to access small amounts of credit for short term use.

58. CAS recommends a consultation on defining when and for what reasons lenders can justify re-pricing (increasing the interest on) an existing debt. There needs to be a process by which consumers can file complaints against the re-pricing of debt.

<u>Credit Limit Decreases:</u>

59. A cap on interest rates on credit available to existing clients may lead credit companies to decrease the credit limit currently available to these clients. CAB evidence shows that clients who have had their credit limits decreased have been hit with unforeseen and unfair charges, particularly where clients are over drawn on their account and subject to higher penalties as a result of such a decrease. Consequently, a sudden and significant decrease in credit has left many consumers financially worse off.

[4] CAS, *Drowning in Debt,* 2009; p10

A West of Scotland CAB reports of a client who has a store card with a limit of £2200. The client has been making regular payments on the card which currently has an outstanding balance of £600+. The client's card was recently denied and upon contacting the store card department the client was advised that a credit check had been conducted on old clients and that she would have to pay the existing balance and then re apply for a store card.

60. Any unsolicited credit limit decreases should be regulated and should ensure it does not lead to further indebtedness.

Q11. How effective have the Competition Commission's remedies been in improving prices for home credit customers? Is further action needed to ensure that consumers of home credit get a fair deal?

61. The OFT review of high-cost credit found that competition was limited and not very effective so further remedies need to be taken to ensure that consumers of home credit get a fair deal. Because home credit customers are targeted in person rather than online a price comparison website is less likely to be effective to change creditor behaviour.

62. CAS recommends that the Government consider ways of increasing consumer protection for consumers of home credit. A separate consultation on the issue would be welcome.

A West of Scotland CAB reports of an 18 year old client who took out a doorstep loan with an APR of nearly 200%. The client borrowed £500 over 18 months ago, but still owes £650. The client needed money after the breakdown of a relationship, but was unable to access more affordable credit.

A North of Scotland CAB reports of a young client who has experienced poor practice from a doorstep lending company. The client states that the initial meeting with the company representative took place in a car park, that payments are made by posting to the representative's other place of work with no receipts for payments provided, and that the representative has stopped her in public to demand payments.

Debt management and remedies

Q15. How can debtors be encouraged to seek early support to help manage their debt problems?

63. Creditors in Scotland are obliged to provide the Debt Advice and Information Package prior to any diligence or application for bankruptcy suggesting that clients in debt contact an Advice Agency for debt advice. This is, however, too late for some of these people. Creditors have the ability to establish indicators to identify clients who owe money and are facing difficulties in making repayments. These indicators should be used to inform clients facing problems of the availability of free, independent debt advice at the earliest opportunity.

Q16. Do the current debt relief options strike the right balance between the needs of the debtor and the rights of the creditor?

64. Debt remedies are devolved in Scotland. Debtors in Scotland can currently access debt relief options through protected trust deeds and bankruptcy. Under both options the debtor will have their non essential assets realised to pay off outstanding creditors. Debtors will also, for a period of up to three years, make a contribution to their debts from available income.

65. Both these options would be considered a last resort for clients and will severely affect their credit rating for some years.

66. From 2008, clients with low incomes and who have low assets have been able to access bankruptcy if they are able to pay a fee of £100. This is the Low Income Low Asset (LILA) route to bankruptcy.

67. The consequences of these remedies on a debtor can be very harsh and may mean that they struggle to maintain a bank account (and consequently a job as they need somewhere to pay wages into) and also may mean they are unable to remain in their home (which can also have significant consequences). More assistance should be available for debtors to ensure that they are not unduly harshly treated.

> An East of Scotland CAB reports of a client who applied for sequestration under the LILA route to bankruptcy and has subsequently received a letter from her bank stating that they had been contacted by the Accountant in Bankruptcy and would be freezing her account as a result. The bank invited her to open a new account, however, on further contact she was advised that she could not in fact open one. The client needs an account for her wages to be paid into.
>
> An East of Scotland CAB reports of a client who used to work as an Engineer but left his employment due to emotional trauma suffered after the death of his sister. The client did not claim any benefits and has accumulated Council tax debt over the years. He has been made bankrupt twice for these debts

and the client has now been advised by the Accountant in Bankruptcy that they will be taking legal action to recover his house.

Q17. What problems are encountered with the current range of debt solutions and how could they be improved to ensure all debtors have an option and that the choices are clear?

68. As mentioned, debt remedies are devolved in Scotland. Unless clients are able to repay their debts in full their home is likely to be at risk. Currently in Scotland the only way to ensure that your home will not be at risk is to pay all your debts in full through the Debt Arrangement Scheme (DAS). With average levels of debt increasing this option is only available to some clients.

69. The Home Owner and Debtor Protection (Scotland) Act 2010 introduced the possibility of debtors being able to access a protected trust deed without their home vesting in the trustee - but this will only be achievable if all creditors accept that the home will not be included and this is only likely to happen where there is a very small level of equity.

70. There is also the issue of debtors being unable to afford the Low Income Low Asset (LILA) route to bankruptcy's £100 fee.

71. CAS continues to make recommendations on debt remedies to the Scottish Government and relevant stakeholders.

Q18. Is there sufficient flexibility within the current range of debt solutions to allow for debtors changing circumstances?

72. On the whole, there is sufficient flexibility within the current range of debt solutions to allow for debtors changing circumstances. Bureau clients who experience a change in their circumstances are able to amend their payments within the Debt Arrangement Scheme (with the agreement of the DAS Administrator) and also Protected Trust Deeds and Bankruptcy (with the agreement of their Trustee). Clients who are unable to maintain payments to their Debt Payment Programme and do not anticipate their circumstances improving can apply for bankruptcy or (following revocation by the DAS Administrator) choose to enter into a Protected Trust Deed.

Q19. Do the current options allow and encourage those who are in a position to repay their debts to do so? If not, why not, and how might any incentives be improved?

73. The Debt Arrangement Scheme works very well for those clients who are in a position to repay their debts in full. More clients could access this Scheme if composition agreements were part of the Scheme (currently they can be agreed voluntarily but very few creditors will agree to this).

Q27. Should there be more consistency on how a debtor's income, assets and expenditure are calculated and treated in different procedures?

74. Assets should only be at risk if the client enters into a formal insolvency procedure e.g. bankruptcy. If the client is paying debts in full, for example

using the Debt Arrangement Scheme then the clients assets should be fully protected from creditor action.

75. The Common Financial Statement which is collectively sponsored by the Money Advice Trust (MAT), the British Bankers' Association (BBA) and Finance & Leasing Association (FLA) is the most commonly used tool by our advisers. It would be helpful if this was used by all those involved in different procedures to ensure that the client is treated in an equitable manner

Q28. Should any changes be made to improve the consistency of investigation and enforcement action in relation to debtors entering insolvency procedures?

76. Currently creditors have the ability to object to clients entering into a Protected Trust Deed which is likely to result in the client being made bankrupt.

77. Debtors must co-operate with the trustee in a Protected Trust Deed and should they fail to do so risk being made bankrupt by the trustee.

78. These procedures ensure that a client will face a consistent investigation of their circumstances and will lead to the same enforcement as bankruptcy is always the ultimate sanction

Q 29. What Outcomes should such investigations be looking to achieve – for example, should they just relate to restrictions on future conduct or should they also impact on discharge from liabilities?

79. Currently bureaux clients who have accepted/or had court action to prove that a debt is due to fraud will not be discharged from that liability. If there is no deliberate fraudulent action by the client then they should be discharged from the debt

Temporary income shock

Q20. Do the current options allow a person to deal effectively with a temporary income shock and if not, what is needed?

Q21. Is some form of moratorium or creditor action required to a) allow a short time period for a debtor to seek and act on advice from a qualified adviser and b) allow a more extended period for a debtor suffering from a temporary difficulty to recover and start making repayments once more. If so, how might such an arrangement work?

80. The economic crisis has brought with it a spate of redundancies, long periods of unemployment as well as reduced working hours for people in employment. This has resulted in significant loss of income, delayed wage payments, and other contractual issues. Clients who had been making payments on their credit and/or store cards suddenly find that these debts are unsustainable for an indeterminate period of time.

> An East of Scotland CAB reports of a client who has recently been made redundant and has used his redundancy money to pay off major debts. However he is still unable to pay off multiple credit card debt of £15,000.
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> A West of Scotland CAB reports of a client with a young family (including a baby) who has been made redundant and is struggling to make payments towards a £5500 credit card debt.
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> A West of Scotland CAB reports of a client who is a homeowner and now unable to meet his mortgage payments and multiple credit card debts, the latter amounting to £40,000.

81. Many owners of small businesses have found themselves in a position where they either pay off their debts by whatever means or close their doors for good. Some have resorted to making payments to their creditors using personal credit cards - adding to their list of creditors and to unsustainable levels of debt.

> A North of Scotland CAB reports of a client who used £130,000 of personal credit cards debt to finance a business that has since failed. Due to a lack of income the client is now struggling to make payments.
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> An East of Scotland CAB reports of a client who is a sole trader and owes £60,000 in credit card debts, £50,000 in loans (including to his family) and more than £20,000 to the HMRC. He is unable to make payments to his unsecured debt and has been served a notice to pay more than £6,000 to one of the creditors. The client expects his business to pick up in the near future.
>
> A North of Scotland CAB reports of a client whose business went into liquidation a few months ago and now owes his credit card provider almost £12,500. The client has become ill and even though his wife is willing to pay his debt, she needs more time to be able to make the repayments.

82. Most recent evidence from CAB across Scotland shows that some creditors have been sympathetic and accommodating to clients' circumstances while others have been indifferent and forceful even when they know that clients are actively seeking ways of managing their financial situation. This is particularly distressing for clients who have used the services provided by a financial institution over a long period of time.

A West of Scotland CAB reports of a client who accumulated close to £10,000 on his credit card since his business failed. The CAB is trying to get the interest on this account frozen but the credit card provider is unwilling do this until a default notice has been issued and the account passed onto their debt recovery department. The client is upset with this treatment particularly as he has done business with this financial institution for more than 20 years.

A North of Scotland CAB reports of a client who has multiple credit cards from the same financial institution and has been making minimum payments until recently when she lost her job. She has since been trying to manage her finances on a reduced income. Though the CAB has made a repayment offer to the creditor on behalf of the client, the client received a threatening phone call from a representative of the company advising her that she had to make a large payment immediately, demanding direct debit details for the client's bank account. The client felt pressured into paying the large amount.

Client interview from Drowning in Debt[5]:

"I went to them (bank) before I missed any payments and said: ' I need to sort a lower payment out. We're in a bit of a financial difficulty right now'…They said to me 'no, you have to get into trouble before we can help you'…We had everything with them and had paid them and not missed anything, they still weren't very good. So I couldn't believe that…I guess it's a way to get more money out of me."

83. The consumer white paper released by BIS last year refers to the agreement reached by the UK Government and creditors on the establishment of a breathing space for clients in financial difficulty and who approach their creditor through a not- for – profit debt adviser[6]. Accordingly the Credit Service Association put this into their code of practice as well. This breathing space has been welcomed by the advice sector and should continue to be strongly enforced by creditors and debt collectors. It would serve the interests of vulnerable debt clients to have the breathing space available to them directly. Creditors should be required to refer these clients to a not for profit debt adviser accordingly.

84. A larger breathing space may be more helpful for clients suffering from temporary income shocks particularly as employment shocks can last for months. A consultation on an acceptable time period for the provision of a breathing space would be welcome.

[5] Citizens Advice Scotland, *Drowning in Debt: Scottish CAB Clients and Debt,* June 2009, p38
[6] BIS, *A Better Deal for Consumers,* 2009;p 74

Payment Protection Insurance:

85. In 2009/10 CAB across Scotland dealt with 1,398 problems relating to Payment Protection Insurance. CAB debt clients who rely on payment protection insurance to help them out in times of such financial difficulty have found that assistance through this type of insurance is not always easily accessible and that payment protection insurance terms and conditions have been unclear on which financial circumstances are covered and which are not.

86. According to research findings in the *Drowning in Debt* report, one third of Scottish CAB clients had payment protection insurance, and only a third of these had made claims. Only 16% of these claims had been successful. Clients with unsuccessful claims are left struggling to meet monthly payments and manage an unsustainable level of debt.

A West of Scotland CAB reports of a client who had payment protection on his credit card and requested assistance from the insurance when he lost his job and was unable to meet minimum monthly payments on his account. The client's claim was subsequently denied on the basis that he had recently used his credit card abroad and so was not covered by the insurance. The client had been making regular insurance payments during this time.

A West of Scotland CAB reports of a client who became redundant when the company she worked for suddenly shut down. The client became depressed and ill because of the situation and qualified for Employment Support Allowance (ESA). Her payment protection provider refused her claim to cover her credit card debts because she wasn't considered unemployed if on ESA. This has added to the client's health issues.

87. CAS has previously responded to the Competition Commission's call for evidence[7] on this issue and produced a briefing sheet highlighting our concerns and continues to recommend increased transparency, clarity and consumer protection[8].

[7] Isaacs, Lindsay, "Payment Protection Insurance, A Response from Citizens Advice Scotland", March 2007
[8] Citizens Advice Scotland, "Payment Protection Insurance", briefing paper published April 2007

Debt advice and assistance

Q 22. How does a person find out where to go for debt advice and assistance? What are the advantages and disadvantages of each method?

Q 23. How does a person know that he/she has been given the ‘right’ advice?

Q 24. What evidence do you have to suggest that debtors end up in the ‘wrong’ solution and what is the scale and impact – for the debtor, the creditors, the economy?

Q 25.Is it clear in all circumstances what the ‘right’ solution should be?

Q 26. How often do debtors move from one remedy to another and could the costs be reduced in some way?

Debt advice in citizens advice bureaux

88. Citizens advice bureaux continue to provide essential advice and support to thousands of debtors across Scotland. In 2009/10, bureaux helped clients deal with more than 370 issues for every day of the year. Many of the clients bringing debt issues to bureaux require assistance with debt solutions.

89. Bureaux have strong brand recognition for the majority of people in Scotland, with many choosing a bureau as their first option for advice on a number of issues. Research undertaken by Consumer Focus Scotland (*Cause for Complaint?* 2010) found that 49% of respondents would approach a bureau for debt advice. Research undertaken by the Scottish Consumer Council found that 90% of consumers had heard of citizens advice bureaux and that 63% of consumers said they would use a bureau for a consumer complaint.

90. A survey by Ipsos MORI in 2009 found that clients have a highly positive view of the services offered by citizens advice bureaux. The survey found that 98% of clients felt able to trust the service and were satisfied with the service provided; nine out of ten would use the service again, while 85% agreed that the Scottish CAB service was the ‘leading advice agency in Scotland’.

91. Citizens advice bureaux offer a range of advice and support to debtors, ranging from setting up a repayment plan with creditors to assisting a client to apply for bankruptcy. Certified money advisers are able to help clients access a range of debt solutions, such as the Debt Arrangement Scheme (DAS) and the Low Income Low Assets (LILA) route to bankruptcy in Scotland, as well as provide appropriate referrals for Protected Trust Deeds.

Other sources of debt advice and debt solutions

92. The debt solutions available in Scotland differ from those offered in the rest of the UK. However, the organisations providing these solutions, such as advice providers and debt management companies, are often the same and are covered by UK consumer laws.

93. A number of the clients bringing debt issues to bureaux had accessed debt advice previously, often receiving inappropriate advice on debt solutions. This includes a number of clients who had received advice from debt management and claims handling companies. In some cases, clients had benefited from appropriate advice, but in many others it had been poor advice on debt from these companies that had caused the client to seek advice from a bureau.

94. The OFT's investigation into debt management firms, published in September 2010, found widespread problems including misleading advertising and poor advice to those in debt. The report stated that firms are charging for their services upfront, and are not giving the advice or offering the solution that is in the best interests of the consumer, but instead that which is most profitable to them. 129 debt management companies were told to improve standards or facing losing their licences.[9]

95. Citizens advice bureaux have seen a number of cases in which clients had paid a large amount of money to debt management companies to be considered for debt solutions that were inappropriate for their financial situation.

A South of Scotland CAB reports of a client who visited a bureau for debt advice after previously approaching three debt management companies. All three had asked for an upfront fee to "consider" his case in the region of £50. All three had then declined to take on his case.

A North of Scotland CAB reports of a client who was charged £900 by a claims handling company to have a loan written off. The client has since heard nothing from the company. The client and his wife were both made redundant from the same company and suffered debt problems as a result.

A North of Scotland CAB reports of a client who was given inappropriate debt advice by a company whose name and logo were very similar to a government debt solution. The bureau commented that the debt solution and company name could easily be confused with each other. The client had been advised by the company to enter a Protected Trust Deed, however it had not been explained to the client that this option would have put his house at risk.

[9] OFT press release at http://www.oft.gov.uk/news-and-updates/press/today?prid=745674

96. One of the results of the recession has been the appearance of debt or claims management companies who fraudulently offer to reclaim money or wipe out debts for clients. A number of bureaux report that clients have paid significant sums of money to these companies who then seem to no longer exist when the client tries to contact them.

A West of Scotland CAB reports of a client who paid nearly £1,000 to a debt management company who claimed that they could help him claim money back if he had been mis-sold a loan. When the client tried to call the company a few weeks later, he discovered that they no longer existed and that the call had been received from Spain.

A West of Scotland CAB reports of a client who paid over £500 to a debt management company who offered to help him reclaim unfair charges made by his bank. The company gave the client a Glasgow address, but after writing to the company, the client was informed that they were no longer at that address. The client has subsequently been unable to contact the company on any avenues suggested by their website. The client says that he has received several phonecalls recently from firms offering this type of service.

An East of Scotland CAB reports of a client who was coldcalled by a 'claims handling company' whom he paid nearly £500 to write off a hire purchase debt. The company has now disappeared along with the client's money.

97. These cases indicate the difficulties that consumers can experience when looking for relief from their debt problems and the serious consequences that they can experience when they receive fraudulent or inappropriate advice.